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# Supreme Court of the United States

OCTOBER TERM, 1927.
No. 130

THE EQUITABLE TRUST COMPANY OF NEW YORK, as Trustee in Bankruptcy of KNAUTH, NACHOD & KUHNE,

*Petitioner,*

*against*

THE FIRST NATIONAL BANK OF TRINIDAD, COLORADO,

*Respondent.*

## BRIEF FOR PETITIONER

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Petitioner,

*against*

THE FIRST NATIONAL BANK OF TRINIDAD, COLORADO,
Respondent.

## BRIEF FOR PETITIONER.*

This case comes to this Court on a writ of *certiorari* to the Circuit Court of Appeals for the Second Circuit whose decree reversed a decree of the United States District Court for the Southern District of New York. The decision of the Circuit Court of Appeals allowed the reclamation claim of the respondent, The First National Bank of Trinidad, Colorado, (hereinafter referred to as the Trinidad Bank) against the estate in bankruptcy of Knauth, Nachod & Kuhne (hereinafter referred to as "K. N. & K.").

### The Opinions Below.

The opinion of the Special Master and of the District Court disallowing the reclamation claim are not officially

*The italics throughout have been inserted by counsel.

reported, but appear at folios 598 and 667 of the Record. The opinion of the Circuit Court of Appeals reversing the decision of the District Court is reported in 13 Fed. (2d) 732.

**The Grounds of this Court's Jurisdiction.**

The jurisdiction of this Court is based upon a writ of *certiorari* which on November 23, 1926, was granted under Judicial Code Section 240 (A) as amended by the act of February 13, 1925, to review a final decree entered on July 13, 1926 (fol. 772) in the bankruptcy proceedings of K. N. & K.

**The Present Case Important as a Test Case.**

This is a test case. There are pending undetermined in the District Court approximately two hundred and twenty reclamation claims similar in varying degrees to the present one, filed on behalf of various inland banks and bankers. Those petitions seek to recover the aggregate sum of approximately $800,000 which it is asserted came into the possession of the trustee in bankruptcy, the petitioner herein. The claimants insist that the sums sought to be recovered are not part of the bankrupts' estate but in equity belong to them. Accordingly the reclaimants seek to have their claims paid in full out of these funds rather than have their claims share *pro rata* with all the general creditors of the bankrupts. Of these claims, approximately two hundred are represented by the attorneys for the present respondent and a list of the various banks and bankers throughout the country represented by them appears in the stipulation annexed to the reclamation petition herein (fol. 25).

The facts with respect to all of such other claims are not, however, identical with those of the case at bar. The facts with respect to the claim of the Fidelity Trust

Company of New York are typical of one of the groups of claims pending undetermined, which differ in one important fact from the present case. Accordingly the Fidelity Trust Company, pursuant to leave obtained, has filed a brief herein as *amicus curiae*. For convenience, the petitioner will reply to the brief *amicus curiae* in a separate brief to be filed herein.

It is hoped that the ultimate determination of the claim of the Trinidad bank will make unnecessary the trial of the other claims. To that end petitioner respectfully urges this Court to include in its opinion a discussion of both causes of action set forth in the Respondent's petition as well as of the theory advanced in the brief of the *amicus curiae*.

## Statement of the Salient Facts, Showing the Successive Steps in the Transactions Between the Trinidad Bank and the Bankrupts, K. N. & K.

The transaction from which the controversy here arose was not a single, particular, exceptional or isolated one. It was one of literally thousands of similar transactions which the bankrupts and innumerable banks and dealers in foreign exchange were parties to daily.

K. N. & K., prior to their failure in June, 1923, were large dealers in foreign exchange. They maintained large foreign balances and in their own name issued large numbers of foreign drafts.

The First National Bank of Trinidad, Colorado (hereinafter referred to as the Trinidad bank) and the numerous other inland banks and bankers maintained no foreign balances, had no foreign correspondents and had no facilities for directly drawing and selling drafts on foreign banks and bankers. In order to enable the inland banks to issue drafts in their own names and, perhaps, to impress their customers with the facilities which the

banks were able to offer, K. N. & K. offered a "Drawing Service," under which the various inland banks could draw *their own drafts* on foreign correspondents listed by K. N. & K. just as if the inland banks did have foreign correspondents; and K. N. & K. undertook to provide sufficient funds for the payment of such drafts abroad (fols. 420, 423, 474).

In summary, the arrangement was as follows:

(1) K. N. & K. sent to their inland bank correspondents, including the Trinidad bank, daily rate cards fixing the rate for the various foreign currencies (Italian lire in this case) under the Drawing Service (fols. 70, 434). The rates quoted were "good" only during the day printed on the cards (fol. 434).

(2) Upon the request of its customer in Colorado, the Trinidad bank would sell *its own draft* on one of the foreign correspondents named in K. N. & K.'s list, for the desired amount of foreign currency, and would receive payment therefor at the rate fixed in the rate card, plus whatever profit the Trinidad bank sought to charge its customer. *The name of K. N. & K. did not appear on the draft. So far as the bank's customer knew*, the Trinidad bank maintained direct relations with the foreign correspondent (fols. 70-72).

(3) Immediately upon the issuance of the draft, the Trinidad bank would send to K. N. & K. an advice (Claimant's Exhibit 4, p. 161), of the drawing of the draft, requesting K. N. & K. "to *protect* same *upon presentation*." With the advice was sent a sum in American dollars at the rate fixed in the rate card.

(4) Upon receipt of the advice and check, the check was deposited in one of the general checking accounts of

K. N. & K., in the Guaranty Trust Company in this case (fol. 74).

(5) On the day that the advice was received from the Trinidad bank, K. N. & K. also sent its advice to the foreign bank upon which the draft had been drawn by the Trinidad bank, including in such advice not only all drafts which had been drawn that day on that foreign correspondent of K. N. & K. by all *other* inland banks availing themselves of the Drawing Service, but also drafts drawn *by K. N. & K. themselves*. All the advices to one foreign correspondent which went forward by one steamer were known as a "Steamer Block" (fol. 75).

(6) The "Steamer Block" was in two parts—(a) one advice to the main office of the foreign drawee, and (b) an individual advice to each branch of the foreign drawee upon which drafts had been drawn that day (fol. 76). The advice to the *main office* of the foreign bank upon which the draft was drawn (the Banca Commerciale Italiana in this case, hereinafter for convenience referred to as B. C. I.) requested the B. C. I. "to *protect* to the debit of *our* account the drafts as per particulars on the attached copies" (Claimant's Exhibit 6, p. 163). Attached to the foregoing, were copies of the advices which had been sent to the *branches* of the B. C. I. (Claimant's Exhibits 6A, 6B, 6C, 6D, 6E). The particular draft here involved is found in the advice sent to the Sassari Branch of the B. C. I. (Exhibit 6D). This advice to the branch banks contains the following direction:

> "Please *honor* the above listed drafts charging same to *our* account with Banca Comm. Italiana Genoa."

(7) When the B. C. I. received the above mentioned advices, it thereupon debited the account which K. N. & K.

maintained with the bank at its Genoa office to the extent of the aggregate of the drafts, and simultaneously credited on its books an account termed "Drafts Payable," in which account were also credited amounts of drafts which were advised to the B. C. I. for payment by other depositors or clients of the B. C. I. (fol. 92). Thereafter, no interest was allowed to K. N. & K. or to anyone else upon the amount credited to the Drafts Payable Account, but on the other hand, the B. C. I. received no compensation for its services in honoring drafts except the compensation measured by its use, without the payment of interest, of the money in the Drafts Payable Account (fol. 93).

(8) *All drafts were thus dealt with* whether drawn by K. N. & K. themselves or drawn by their inland correspondents (See Claimant's Exhibit 6A, fol. 490, which includes advice of drafts issued by "Ourselves").

(9) It appears in evidence *without contradiction* that there is a well recognized banking custom of long standing, under which the foregoing practice is pursued, and that the reasons for the practice are that by making such bookkeeping entries (a) the drawee bank at all times knows of its possible demand obligations and can keep itself in a position to meet the drafts which have been advised, and (b) as sole compensation for its services in the transaction, it is enabled to use the funds during the interval before the presentation of the drafts without paying interest thereon (fols. 93, 359).

(10) It also appears without contradiction from the testimony of the expert Dawson, Vice-President of the Guaranty Trust Company of New York, that under the foregoing well established banking custom and practice, the American depositor who has an account in the for-

eign bank *may cancel the advice* of a draft *drawn either by himself or by his inland correspondent*, without obtaining the consent of the payee of the draft or the inland correspondent, and that the foreign bank recognizes and obeys only the orders of its own client without inquiring as to any one's else instructions (fol. 368).

On this point it was stipulated (fol. 378):

> "Whenever, prior to the payment of a draft which has been advised abroad in the form of Exhibits 6 to 6-E, the bankrupts notified the Banca Commerciale Italiana to cancel any specific advice or advices, or to stop payment on any draft or drafts covered therein, Banca Commerciale Italiana forthwith recredited the bankrupts' account with the amount of said draft or drafts and at the same time debited the account termed 'Drafts Payable' for the same amount. This was done without knowledge on the part of Banca Commerciale Italiana as to whether such draft or drafts were in the possession of the bankrupts, the drawer banks or third persons."

It also appears that B. C. I. cancelled drafts at the request of K. N. & K. without being informed that the cancellation was made upon the request of the Trinidad Bank (fol. 222). While it was also stipulated (fol. 379) that in the case of the present respondent, K. N. & K. had never cancelled an advice without a previous request to do so from respondent, this has no bearing on the question of K. N. & K's. relations with their foreign correspondents and K. N. & K's. control over their foreign balances. It should also be noted that K. N. & K. had regular forms for cancelling advices used for both their own and inland bank drafts (Trustee's Exhibits 3 and 4, p. 192 and fol. 383). *Thus it appears that at all times K. N. & K. kept control over their foreign balances and could cancel the advices as they saw fit.*

(11) There is no evidence that the draft holder had knowledge of the existence of the Drafts Payable Account or of the existence of the Drawing Service.

(12) In the present case, the advice of the Trinidad draft was not cancelled prior to the filing of the petition in bankruptcy, but immediately upon the appointment of the receiver, he cabled to the B. C. I. that he had taken possession of the assets and that all of the bankrupt's credit balances must be held subject to his order (Claimant's Exhibit 10, fol. 520). Thereafter the B. C. I. acquiesced in the Receiver's view that the balances in the Drafts Payable Account belonged to the bankrupts and such balances in the general account of K. N. & K. with the B. C. I. *and the balances in the drafts payable account* were returned to the receiver by the B. C. I.

(13) *After* the bankruptcy, the draft was presented to the drawee and payment refused (fol. 330). Thereupon the draft was returned to the purchaser thereof and the Trinidad bank paid to such purchaser the purchase price thereof and received the draft (fol. 330).

**The Theory of the Claim of the Trinidad Bank.**

The reclamation petition of the Trinidad Bank (fol. 1) asserts a right to recover specific moneys which came into the possession of the trustee in bankruptcy under the following two distinct counts or causes of action:

(A) That by the terms and conditions of the Drawing Service the American dollars which the respondent paid to K. N. & K., as described in paragraph (3) above, were initially received by K. N. & K. in trust and that said funds have in fact come into the possession of the trustee.

(B) That pursuant to the terms of the Drawing Service, K. N. & K. had equitably assigned the portion of its balance in the B. C. I. which had been credited on the latter's books to the Drafts Payable Account (under the circumstances described in paragraph (7) above) and that the amount of that credit has been returned to the trustee in bankruptcy by the B. C. I. as set forth in paragraph (11) above, and is the property of the respondent.

**The Contentions of the Trustee in Bankruptcy.***

The trustee in bankruptcy contends:

(*a*) That K. N. & K. were acting as *entrepreneurs* who, in consideration of American dollars paid in advance, assumed an executory obligation to "protect the draft *on presentation.*" That is K. N. & K. undertook to have a sufficient balance in lire at the Italian bank, the B. C. I., upon the presentation of the draft of the Trinidad bank, so that the draft would be "honored" upon such presentation to the debit of K. N. & K.'s balance in pursuance of ordinary banking practices and in the same manner as the drafts which K. N. & K. themselves drew would be honored.

(*b*) That the arrangement of the parties did not contemplate that a fund should be set up *in advance* which should be the sole source for the payment of the Trinidad bank's drafts. The arrangement contemplated that K. N. & K. would protect the draft on its *presentation*, i. e., would see to it that the draft was *paid*.

(*c*) The *acquiescence* by K. N. & K. in the foreign bank's practice of charging K. N. & K.'s account on the receipt of the advice and crediting the Drafts Payable Account was not intended to constitute performance

*A complete Brief of the Argument is included in the Index.

of K. N. & K.'s obligation or an appropriation in advance of a fund from which the draft was to be paid. For the same practice was pursued with respect to drafts drawn by K. N. & K. themselves where clearly there was no conceivable obligation to provide a fund in advance, inasmuch as they were not drawing pursuant to any special contract like the "Drawing Service." Furthermore, as above pointed out, K. N. & K. at all times remained in complete control of their entire balance including that portion credited in the Drafts Payable Account.

(*d*) The uncontradicted evidence shows that the practice of crediting the Drafts Payable Account existed independent of any "Drawing Service" and for wholly different reasons.

Answering specifically the claims of the Trinidad Bank as set forth in its reclamation petition, the trustee in bankruptcy contends:

(1) That under the terms of the Drawing Service and the forms provided therewith, no trust relationship arose between the Trinidad Bank and K. N. & K.

(2) That the parties dealt as independent contractors and that the moneys paid to K. N. & K. by the Trinidad bank were paid for K. N. & K.'s obligation to produce a certain result, namely, the honoring of the draft by B. C. I. upon its presentation. In short K. N. & K. agreed to protect, in the same manner as drafts drawn by themselves, the drafts drawn by the Trinidad or other inland banks.

(3) That there was no agreement to assign any funds abroad and that the acts of K. N. & K. after the receipt of the American dollars, did not result in an equitable assignment; that these acts were done solely in pursuance of the banking practice already described.

(4) That the balance in the B. C. I. which is sought to be reclaimed remained the property of and was always wholly within the control of K. N. & K. and K. N. & K. alone was the creditor of the B. C. I. Prior to the filing of the petition in bankruptcy the balance in the Drafts Payable Account was property which the bankrupts "could by any means have transferred," by exercising the power of revocation and accordingly was property which vested in the Trustee in Bankruptcy pursuant to Section 70 (a) (3) and (5) of the Bankruptcy Act.

(5) The general object of the Bankruptcy Laws is to afford equality among all creditors remaining unpaid at the date of the bankruptcy and in order to obtain equitable relief or to establish a right to specific funds, the courts have been strict in demanding that the claimant's right be founded upon the clear intention of the parties without vagueness or uncertainty. The respondent here has failed to sustain that burden.

**The Holdings Below in the Present Case and in Related Cases.**

Three cases, involving in some of their aspects the problems here presented, were before the Circuit Court of Appeals for decision at the same time. In the present case that Court held that the credit to the Drafts Payable Account by the foreign bank when it received K. N. & K.'s advice of the drawing of the draft by Trinidad constituted a "performance" by K. N. & K. of its obligation under the Drawing Service; that it was for the benefit of the *holder of the draft* and constituted an equitable assignment to him of the balance so credited and a discharge of K. N. & K. And it held, further, that the Trinidad bank having taken up the draft by paying the

holder acquired the rights of such holder. Having reached this conclusion, the Court found it unnecessary to determine whether or not K. N. & K. had initially received the American dollars from the Trinidad bank in trust. A detailed analysis of the Circuit Court's opinion appears at page 42 *post*.

On the same day that the case at bar was decided in the Court below, that Court decided *Matter of Zimmerman & Forshay, Ex parte Henry G. Gray*, 14 Fed. (2d) 527. In that case the bankrupts, Zimmerman & Forshay, sold to Gray a draft which *they themselves* had drawn on a foreign bank with which they maintained a balance. *There was no special contract similar to the Drawing Service used in the present case.* The draft was advised abroad, charged to the bankrupts' account and credited to a Drafts Payable Account in the same manner as in the case at bar. There, as here, the advice was cancelled after the bankruptcy and before the draft was presented and there, as here, the funds were returned to the receiver in bankruptcy. In that case it was also stipulated that the dealings between the bankrupts, Zimmerman & Forshay, and the foreign bank were such that when the bankrupts drew the draft on the foreign bank "and later for any reason wished to stop payment that a direction to stop payment will be honored by the bank." Despite the absence of even the semblance of a special agreement for the creation in advance of a special fund to meet the check, the Court below nevertheless held that the claimant was entitled to recover the moneys which had been returned to the receiver in bankruptcy. It was forced so to hold to remain consistent with its decision in the present case. (See p. 44 *infra*.)

Also on the same day the Court below handed down its decision in *In re Gubelman, Ex parte Munteau*, 13 Fed (2d) 739. That case arose in this same bankruptcy proceeding of K. N. & K. A general claim had been

filed by Muntean, the holder of a draft issued by an inland bank under the same Drawing Service as that used by the Trinidad bank in the present case. After payment of the draft had been refused abroad, instead of presenting that draft to the inland bank which had issued it, the holder, Muntean, filed a general claim directly with the bankrupt estate. The trustee objected to the claim on the ground that there had been no contractual relationship between K. N. & K. and the holder of the draft and that, therefore, the holder of the draft had no provable claim in bankruptcy. In other words, the trustee asserted that the claim was based on the theory that the contract between the inland bank and K. N. & K. had been made for the benefit of the holder of the draft issued by the inland bank. The Circuit Court of Appeals, however, held that the facts in the *Muntean* case were not within the Federal third party beneficiary doctrine inasmuch as the contract between K. N. & K. and the inland bank had not been made primarily for the benefit of the draft holder but rather for the benefit of the inland bank itself.

As will be shown hereafter, the foregoing decisions handed down on the same day as the one in the case at bar are important because they will make clear the errors which underlie the determination of the Court below in the present case.

**Conflicting Theories of the Trinidad Bank and of the amicus curiae, Fidelity Trust Company of New York.**

As has been shown, the theory advanced by the Trinidad bank and adopted by the Court below was that because of the credit to the Drafts Payable Account abroad, the balance in that account had been equitably assigned

to, or irrevocably appropriated for, the benefit of the holder of the draft, to whose position the Trinidad bank was thereafter subrogated by its taking up the draft. The Fidelity Trust Company on the other hand, in its brief filed herein as *amicus curiae*, not being in a position to show a credit to the Drafts Payable Account abroad, has been forced to contend that the mere advice by K. N. & K. to the foreign bank, when received abroad, worked an equitable assignment of an aliquot part of, K. N. & K.'s foreign balance in favor, *not of the draft holder, but of the drawer bank.*

This conflict evidences the attempt of the banks contracting with K. N. & K., after the latter's bankruptcy, to secure for themselves on one theory or another a position entitling them to priority in payment, to the detriment of the general creditors of the bankrupt estate.

**Desirability of an Opinion on All Points Presented.**

In view of the fact that this is a test case, decision in which it is hoped will dispose of many reclamation claims and lead to a prompt termination of litigation, petitioner respectfully requests that this Court express its views not only upon both causes of action set forth in the Trinidad bank's petition but also on the theory advanced in the brief of the Fidelity Trust Company as *amicus curiae*.

Since, however, the decision below is based entirely on the Trinidad bank's second cause of action, i. e., that there had been an equitable assignment—the petitioner-trustee will first discuss that conclusion.

## POINT I.

**Neither the contract of the parties nor any of the acts done by K. N. & K. or the B. C. I. after the receipt of the American dollars by K. N. & K. were intended to constitute or did constitute an equitable assignment of K. N. & K.'s balance in the B. C. I. as alleged in the respondent's second cause of action.**

In considering the respondent's second cause of action in which an equitable assignment is alleged, the Trustee will

A. State the legal principles applicable to equitable assignments.

B. Indicate what the respondent's contentions are and what their necessary results must be.

C. Show that there was initially no intention or obligation to make an assignment of any fund in advance of the presentation of the draft—which will involve an analysis of the contract of the parties.

D. Analyze the acts of K. N. & K. and the B. C. I. after the receipt of the American Dollars by K. N. & K. and show that the acts of both of these parties were not intended to constitute an equitable assignment of any fund in pursuance of any contract, but were done merely in pursuance of well established banking practices under which the credit always remained the property of and under the control and subject to the disposition of K. N. & K. until the presentation and payment of the drafts.

E. Analyze the opinion in the Circuit Court of Appeals and point out its fundamental errors.

F. Analyze the leading authorities on equitable assignment.

G. Distinguish the authorities relied on by the respondent and the Court below.

### A. Tests of Equitable Assignments.

(1) There can be no equitable assignment of a fund to come into existence unless (*a*) there was an intention to create an assignment; and (*b*) a *res* has been irrevocably appropriated the creation of which is a carrying out of the intention. Whether or not certain acts amount to the setting up of a *res* is in turn dependent upon the intention with which those acts are done.

*Hamer* vs. *Sidway* (1891), 124 N. Y., 538.

*In re Interboro Consolidated Corporation* (C. C. A. 2nd, 1923), 288 Fed., 334-349.

*Hopkinson* vs. *Forster*, L. R. 19, Eq. 74, where the Court said: "You can have no charge in Equity without an intent to charge. The letter on which you rely was not written with any intent to charge the fund; it was a mere letter of instructions to the bankers."

(2) There can be no equitable assignment unless the assignee knows of and consents to the setting up of the fund.

3 *Pomeroy Eq. Jurisprudence* (4th Ed. 1918), Section 1281 says:

> "Notice to the Creditor Assignee Essential.—Although, whenever a debtor, in the manner above described, makes to his creditor an equitable assignment of a specific fund or debt in the hands of or owing by a third person, the assent of such *third person* is not requisite to the effect of the transfer in equity, *yet the assignment, appropriation, direction, or order is not absolute, but may*

*be revoked by the debtor-assignor at any time before the creditor-assignee has been notified of it, and has expressly or impliedly assented thereto. In such a case notice to and assent by the creditor-assignee are essential to an absolute assignment.*" (And cases there cited.)

(3) There can be no equitable assignment or equitable charge unless the fund is taken in satisfaction of or as security for the obligation.

*Barnes* vs. *Alexander* (1914) 232 U. S., 117, 121;

*Spellman* vs. *Bankers' Trust Company* (C. C. A., 2nd 1925) 6 Fed (2nd), 799.

(4) If the fund or balance set up remains at the risk of the alleged assignor, there has been no equitable assignment.

*Tiernan* vs. *Jackson* (1831), 5 Peters 579, 594;

*Williams* vs. *Everett* (1811), 14 East, 581, 596;

*In re Interboro Consolidated Corporation*, 288 Fed., 334-345, quoting with approval *Story's Commentaries on Equity*, Section 1045, where it is said: "The true test whether an absolute appropriation is made out or not depends upon the point at whose risk the property is; and until the creditor has consented, the property will clearly be at the risk of the assignor or remitter."

(5) If the alleged assignor retains control over the fund or balance or may revoke his instructions with respect thereto, then there has been no equitable assignment.

F. Analyze the leading authorities on equitable assignment.

G. Distinguish the authorities relied on by the respondent and the Court below.

**A. Tests of Equitable Assignments.**

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(5) If the alleged assignor retains control over the fund or balance or may revoke his instructions with respect thereto, then there has been no equitable assignment.

In *Christmas* vs. *Russell* (1871), 14 Wall, 69, this Court said at p. 84:

> "An agreement to pay out of a particular fund, however clear in its terms, is not an equitable assignment; a covenant in the most solemn form has no greater effect. * * * *The assignor must not retain any control over the fund—any authority to collect, or any power of revocation. If he do, it is fatal to the claim of the assignee.*"

In *Cushings* vs. *Chapman* (C. C. Mo., 1902), 115 Fed. 237, the Court said at p. 239:

> "To constitute such an equitable assignment, there must be such an actual or constructive appropriation of the fund or subject matter 'as to confer a complete and present right on the party meant to be provided for, although the circumstances do not admit of its immediate existence'; *that, if the holder of the fund could retain control over it, with the power, sua sponte, on his part, to satisfy the promise in cash, it is fatal to an equitable assignment.* *Christmas* vs. *Russell*, 14 Wall 69, 20 L. Ed. 762; *Bank* vs. *Beal* (C. C.) 54 Fed. 577; *Badgerow* vs. *Trust Co.* (C. C.) 74 Fed. 925; *Ex parte Tremont Nat. Bank*, 24 Fed. Cas. 184; *Foss* vs. *Cobler*, 105 Iowa, 731, 75 N. W. 516; *Stearns* vs. *Insurance Co.*, 124 Mass. 63, 26 Am. Rep. 617; *Williams* vs. *Ingersoll*, 89 N. Y. 518; *Hicks* vs. *Brick Co.*, 94 Va. 746, 27 S. E. 596; *Hassack* vs. *Graham*, 20 Wash. 192, 55 Pac. 36."

See also *In re Stiger*, 202 Fed. 791 affirmed (C. C. A. 3rd, 1913), 209 Fed. 508; and *Spellman* vs. *Bankers' Trust Co.*, supra, at p. 800;

5 *Corpus Juris*, 913.

The following acts have been held *not* to indicate an intention to create an assignment:

(1) The mere advice to a bank of the drawing of a

draft in accordance with international banking practice does not indicate an intention equitably to assign any of the depositor's balance with the drawee.

*Eastman-Kodak Company* vs. *Park National Bank* (D. C. S. D. N. Y., 1916), 231 Fed., 320 (opinion by Learned Hand, D. J.), affirmed no opinion 247 Fed., 1002.

(2) The mere direction to pay a draft and charge it to the account of the depositor does not constitute an equitable assignment nor is there an equitable assignment even if the funds have been placed in the hands of the depositary as a *means* of satisfying the depositor's absolute obligation.

*National City Bank* vs. *Hotchkiss* (1913) 231 U. S., 50;

*Eastman-Kodak* vs. *Park National Bank* (1916), 231 Fed., 320, aff'd. 247 Fed., 1002;

3 *Pomeroy Eq. Jur.*, Sec. 1282, cited with approval in the *Interboro* case, *supra*, at 345, and citing *Cheney* vs. *Libbey*, 134 U. S., 68, 83;

*Aetna National Bank* vs. *Fourth National Bank* (1871), 46 N. Y., 82, 87.

(3) Even an agreement to pay a debt out of a designated fund does not give an equitable lien on the fund or operate as an equitable assignment thereof.

*Williams* vs. *Ingersoll* (1882), 89 N. Y., 508;
*Christmas* vs. *Russell* (1871), 14 Wall., 69.

(4) Mere book entries dividing a bank balance into two or three accounts, as a matter of convenience or in pursuance of a well established custom, do not evidence

an intention to assign a fund, and do not constitute an equitable assignment.

*In re Interboro Consolidated Corporation, supra;*

*Noyes* vs. *First National Bank* (1st Dept., 1917), 180 App. Div., 162, affirmed *on opinion below*, 224 N. Y., 542, and analyzed page 48, *infra;*

*Taussig* vs. *Carnegie Trust Co.* (1st Dept., 1913), 156 App. Div., 519, affirmed, no opinion, 213 N. Y., 627, and analyzed page 78, *infra;*

*Kuehne* vs. *Union Trust Company* (1903), 133 Mich., 602, analyzed page 79, *infra.*

**B. The Necessary Results of Respondent's Contentions.**

Respondent contended and the Court below held that there was an assignment *in favor of the draft holder* whose rights the respondent acquired by taking up the draft.

If the fund with the B. C. I. was intended to be and was equitably assigned to the draft holder, the following results would follow under the foregoing authorities:

(1) At the moment the fund was created, (if a "fund" was created), and even prior to the presentation of the inland draft, K. N. & K. was fully discharged despite the fact that Trinidad remained liable to the holder on its draft.

(2) At the moment the fund was set up, K. N. & K. lost all control over it and the debtor-creditor relationship between B. C. I. and K. N. & K. ceased.

(3) After the fund was set up, it was wholly at the

risk of the inland bank (or of the draft holder); that is, if the B. C. I. in the present case, or if in other cases any one of the hundreds of scattered foreign correspondents named in the list, became insolvent after the fund was set up and before the draft was presented, or for any reason failed or refused to pay the draft upon presentation, the loss would fall, not on K. N. & K., but on the inland banks which in fact did not choose the foreign correspondents or have any knowledge or means of knowledge of their solvency or responsibility.

(4) The various steps taken by or acquiesced in by K. N. & K. would have to be construed as necessarily taken to carry out a previous intention and obligation under the provisions of the Drawing Service to create and assign *in advance* a fund abroad, *despite the fact* (*a*) that those very same steps were taken in the simple case where K. N. & K. issued their own drafts without any such special contract, and (*b*) that such steps are taken by international bankers generally in pursuance of well established usage and custom existing for wholly different reasons and irrespective of any special promise.

*It will now be shown however, that no such results were intended or effectuated;* that K. N. & K. were not discharged until payment of the draft; that K. N. & K. at all times controlled the funds on deposit with B. C. I.; that the risk of loss in the event of the failure of B. C. I. was on K. N. & K. and not on Trinidad; and, finally, that the very steps here taken were the usual and ordinary steps taken in accordance with general international practice and custom, and, indeed, the same steps taken by K. N. & K. in protecting drafts drawn by themselves although no agreement in the nature of the Drawing Service was entered into with respect to such drafts.

As a result, there is no basis for respondent's con-

tention that funds were equitably assigned in favor of Trinidad or the holder of the draft.

### C. Neither the Provisions of the Drawing Service Nor the Acts Done in the Performance of K. N. & K.'s Obligations Were Intended to or Did Constitute an Equitable Assignment.

Having now stated the basic legal principles involved and the necessary results of respondent's contentions, the contract of the parties and the acts done pursuant thereto will be examined and it will be shown that there was no equitable assignment.

#### 1. The provisions of the Drawing Service, and the forms provided for use therewith, do not disclose any intention that any "fund" should be created in advance or assigned for the payment of the draft drawn by Trinidad on the B. C. I.

In construing the provisions of the Drawing Service contract, the Court must consider all of the provisions together in order to determine the purpose and effect of the whole rather than give undue emphasis to isolated words or phrases without their relation to the other provisions of the contract.

The primary purpose underlying the Drawing Service contract and the results which the parties thereto hoped to accomplish is best evidenced by the preliminary statement in the List of Foreign Correspondents (Claimant's Ex. 1, fol. 418). The opening paragraph states:

> "Inasmuch as the maintenance of a Foreign Department *involving the carrying of balances abroad*, etc., is *undesirable* from the standpoint of a majority of the inland banks, we have aimed for

> many years to supply this want by *extending* to our correspondents the privilege of using *our world-wide facilities* for carrying on a foreign exchange business."

It was thus the basic purpose of the Drawing Service to substitute *K. N. & K.'s foreign credit* for the necessity of the inland banks having balances abroad; the latter was declared to be "undesirable." Further, "extending" to the inland correspondents the privilege of using the world-wide facilities of *K. N. & K.* for carrying on a foreign exchange business simply meant that K. N. & K. would make available for the payment of the inland bank drafts *K. N. & K.'s own balances* or credit in foreign countries which K. N. & K. would direct to be charged upon the "honoring" of the draft (Claimant's Exhibit 6D, fol. 499), when presented. The relationship contemplated did *not* involve the setting up abroad of a credit in favor of the inland bank or of the draft holder in advance of the presentation of the draft or, for that matter, at any time. *The scheme here devised was, in its essence, a convenient substitute for the purchase by the inland bank of K. N. & K.'s own drafts upon which K. N. & K. would remain liable despite the failure of their foreign correspondent.*

*Effect of direction of Trinidad to K. N. & K. to protect draft on presentation.*

It is submitted that the most important single document in the chain comprising the contract between the parties is the form of advice *prepared by K. N. & K.* and sent by Trinidad (and of course by every other inland bank using the service each day) to K. N. & K. to instruct K. N. & K. what they should do. This advice (Claimant's Ex. 4, fol. 482), after stating that Trinidad had sold the draft in pursuance of the Drawing Service, added that Trinidad:

> "shall thank you to *protect* same *upon presentation.*"

This direction clearly negatives any idea that K. N. & K. was to create a fund in advance or could by so doing discharge their obligation. The phrase "to protect a draft upon presentation" has a well recognized meaning. It is a personal general obligation to see that the draft is *paid*. That is the meaning which business men, the courts and lexicographers have uniformly given to it. Thus in *Wabash St. L. & Pac. Ry. Co.* vs. *Ham* (1885), 114 U. S., 587, a consolidation agreement provided that the bonds and debts therein specified of the former companies should "be *protected* by the said consolidated company." It was urged that under this provision a lien had been created in favor of the bonds and debts of the former companies upon the assets of the consolidated company. This Court held to the contrary, saying through Mr. Justice Gray, at page 596:

> "The agreement 'to protect' referring to the time of payment, and 'the true meaning and effect' of the equipment bonds having been to create only a personal and unsecured debt of one of the former companies, *the words 'shall be protected' must have the same meaning which they ordinarily have in promises of men of business 'to protect' drafts or other debts not made or contracted by themselves, that is to say, a personal obligation to see that they are paid at maturity.*"

That the foregoing definition has been accepted appears from *Webster's New International Dictionary*, 1924, where the above case is referred to as the basis of the meaning of the word "protect" in commerce and finance:

> "4. Com. & Finance. To see that (a note, draft or other obligation) is paid or satisfied at maturity (114 U. S., 587); as the Consolidated Company

agreed to *protect* the bonds of the individual companies."

And in *Funk & Wagnall's New Standard Dictionary*, the following definition of "protect" is found:

"4. *Finance.* To guarantee payment of or satisfy at maturity, as bonds."

*Robbins* vs. *Robinson* (1896), 176 Pa., 341, 346:

"To 'protect a bill' for the seller means in any reasonable business construction to be answerable for its *payment* * * *."

*The instructions of K. N. & K. to its correspondent—B. C. I.*

That this was the meaning understood by K. N. & K. is confirmed by the language used in the advices sent by K. N. & K. to the B. C. I. (Claimant's Exhibits 6 and 6D, fols. 487, 469). In the advice sent to the main Genoa office of the B. C. I., K. N. & K. requested the B. C. I. to

"Please *protect* to the debit of our account* the drafts as per particulars on the attached copies * * *."

And in the advice sent to the specific branch of the B. C. I. on which the draft in question was drawn (Claimant's 6D, fol. 469), K. N. & K. requested

"Please *honor* the above listed drafts charging same to our account with Banca Comm. Italiana Genoa."

The term to "honor" a draft also has of course a well

*The direction to "protect" to the "debit of our account" was used in the same sense in the advice appearing in the case of *Eastman Kodak Company* vs. *Park National Bank*, 231 Fed., 321, affirmed (C. C. A., 2d), 247 Fed., 1002.

defined meaning. Thus in 30 *Corpus Juris*, 457, it is stated, quoting numerous cases, that "honor" as a verb means:

> "also to accept a bill of exchange, or to *pay* a note, check, or accepted bill, *at maturity* and according to its tenor."

Nothing is said about the transfer of a credit for the benefit of either the Trinidad bank or the holder of the draft. Nothing is said as to the creation of a fund in advance. The instructions are to "protect" and to "honor" the drafts presented.* If the intention had been that K. N. & K. should *in advance* appropriate a fund for the payment of a draft, then it would have been easy to provide simply that K. N. & K. should set up a credit for Trinidad so that when the draft was presented Trinidad would have had a credit *of its own* on the B. C. I.'s books to which its draft could be charged. Transactions of this kind are accomplished daily in great number by the ordinary cable or mail transfers (See *Legniti* and *Gravenhorst* cases, *infra*). If this had been the intention, the lengthy and special provisions of the Drawing Service contract would have been unnecessary. But this was not at all the intention of the parties or the scheme of the Drawing Service. *The underlying purpose of the Service was that the draft should be treated just like a draft K. N. & K. itself had drawn; and just as K. N. & K. would direct the B. C. I. to "honor" or "protect" their own drafts, and would, of course, have a balance there at the time of presentation to meet them, so the scheme was to "protect" the payment of the inland bank's draft by K. N. & K. having a balance with the B. C. I. to which account the draft could be charged when it had been presented and paid.* Such a system required a balance in

*As said in *Hopkinson vs. Forster*, L. R. 19, Eq. 74, supra, "The letter on which you rely was not written with any intent to charge the fund; it was a mere letter of instructions to the bankers."

the form of a K. N. & K. credit *at the moment of presentation and not before.*

Thus only could the inland bank achieve the result which it desired. Only in that way did K. N. & K. remain under an absolute contractual obligation to see to it that the draft was paid upon presentation—to protect it—and remain undischarged until such payment. *Payment abroad is what Trinidad desired. It had drawn a draft upon a bank which it did not know and which K. N. & K. did know. It had relied solely upon K. N. & K. themselves. It wished to look to K. N. & K. in the event that the draft was not paid and it did not wish to trouble itself with foreign credits. That was deemed "undesirable."*

Accordingly K. N. & K. undertook by the general terms of the Drawing Service itself that upon receipt of the advice of the drawing of the draft by Trinidad (referred to above) and the receipt of the consideration in American dollars:

> "We shall promptly forward our advice of the same and provide the drawee *with funds sufficient* for the payment of the draft abroad by a transfer of credit from our balance, or otherwise" (fol. 422).

**Nature of Obligation to Provide Drawee With "Funds Sufficient for the Payment of the Draft."**

The obligation to provide "sufficient funds" was the same obligation as that discussed in *Beecher* vs. *Cosmopolitan Trust Co.*, 239 Mass., 48, analyzed at p. 71, *infra*, where the Court used those very words. But in that case there was no intimation that such funds were to be irrevocably appropriated in advance of the presentation of the draft. And in *Erb* vs. *Banco di Napoli*,

243 N. Y., 45, analyzed at p. 50, *infra*, the Court said that the Italian Government "had *provided funds* to meet its obligations" and yet the Court held there was no trust in favor of the coupon holders.

There was *no* undertaking by K. N. & K. to provide the foreign bank with "*a fund*" for the payment of the draft. K. N. & K.'s only obligation was to provide the drawee with "*sufficient funds*" for the draft's payment. This, in the light of all the documents furnished in the Service meant simply that K. N. & K. undertook to notify the foreign bank that the draft had been drawn and further undertook to see to it that the foreign bank would pay the draft when it was presented. Such payment, upon the presentation of the draft, was to be accomplished either by a transfer from K. N. & K.'s balance—that is by a debit to the K. N. & K. account—or was to be accomplished "otherwise," which, of course, meant that in those cases where K. N. & K. had no foreign balance in the particular drawee bank, arrangement would somehow be made by K. N. & K. for having the draft paid—for example, by directing a foreign bank with which they did have a balance to arrange for the payment of the draft when presented to the drawee, i.e. to "protect" the draft.

It is apparent therefore that under the Drawing Service and the forms used in connection therewith, which together evidenced the contract of the parties, *there was no intention that any fund should in advance be assigned or appropriated to the payment of the draft.* The absence of any such intention *is of itself fatal* to the contention now advanced (in order to obtain a preference over other creditors) that any portion of the balances of K. N. & K. at the time of the filing of the petition in bankruptcy had been equitably assigned.

2. THE ACTS DONE BY K. N. & K. AND BY THE B. C. I. IN THE PERFORMANCE OF K. N. & K.'S OBLIGATION UNDER THE DRAWING SERVICE, INCLUDING THE BOOKKEEPING ENTRIES MADE BY THE B. C. I. PURSUANT TO A WELL ESTABLISHED INTERNATIONAL BANKING CUSTOM, ARE NO EVIDENCE OF AN INTENTION TO ASSIGN OR APPROPRIATE A FUND. THIS IS PARTICULARLY SO, INASMUCH AS K. N. & K. AT ALL TIMES RETAINED CONTROL OF THEIR BALANCE AND HAD THE RIGHT TO CANCEL ADVICES, AND THUS REMAINED THE CREDITOR OF B. C. I.

It has just been shown that the contract of the parties did not contemplate an assignment or appropriation of a specific fund abroad. It will now be shown that the *acts* of the parties—their construction of their obligations *ante litem motam*—do not evidence an equitable assignment.

On receipt of the Trinidad bank's check in American dollars (Claimant's Exhibit 3, fol. 481) together with the advice from Trinidad (Claimant's Exhibit 4, fol. 482) K. N. & K. promptly sent an advice to the B. C. I., upon which Trinidad had drawn its draft. Such advice was composed of a statement to the main branch of the B. C. I. at Genoa (Claimant's Exhibit 6, fol. 487) containing a statement of all drafts drawn on the B. C. I. and its branches for a given period and instructing the B. C. I. to "please protect to the debit of our account the drafts as per particulars on the attached copies." The "attached copies" were copies of advices which K. N. & K. had sent to each of the individual branches of the B. C. I. upon which drafts had been drawn by them or under their protection (see Claimant's Exhibits 6A-6E, fol. 490, *et seq*). One of such copies (Claimant's Exhibit 6D, fol. 499) was addressed to the Sassari branch of the B. C. I. and included an advice of the draft here in question drawn by the Trinidad bank. Such advice requested the B. C. I. to "please *honor* the above listed

drafts charging same to our account with Banca Comm. Italiana, Genoa."

It is important to note that included in the advices sent to the B. C. I. by K. N. & K., were drafts drawn not only by inland bank correspondents of K. N. & K. (such as the Trinidad bank in this case), but also by "ourselves"—K. N. & K. (See, for example, Claimant's Exhibits 6A, fol. 490 and 6E, fol. 502). *In other words, K. N. & K. took exactly the same steps to protect that drafts drawn by themselves as were taken to protect drafts drawn by their inland correspondents under the Drawing Service.* It will also be shown that the B. C. I. on receipt of K. N. & K.'s advice acted in the same manner with respect to K. N. & K.'s own drafts and the inland bank drafts. *Therefore irrespective of other arguments, if no equitable assignment was contemplated or effected as a result of the issuance of K. N. & K.'s own drafts, none was contemplated or effected as a result of the issuance of the inland bank's drafts including the Trinidad Bank draft in this case.*

**The Debiting by B. C. I.**

Upon the receipt of the advice, the B. C. I. charged the amount of all the drafts, both those issued by various inland banks and those issued by K. N. & K. themselves, to the account which K. N. & K. maintained with the Italian Bank, and

> "simultaneously credited on its books an account termed 'drafts payable' in which account were also credited amounts of drafts advised to the said Banca Commerciale Italiana for payment by other depositors or clients of the Banca Commerciale Italiana in addition to the bankrupts" (fol. 92).

The following facts are to be noted:

(1) That K. N. & K. gave no directions to the B. C. I., to set up a fund which should be irrevocably appropriated to the payment of its own and of the inland drafts, but simply directed them to "protect" the drafts to the debit of their account and to "honor" the drafts, charging the same to their account.* *K. N. & K. simply acquiesced in the established banking practice of debiting which had an entirely different purpose.*

(2) That while K. N. & K.'s account in the B. C. I. was debited with the aggregate of all the drafts (*a*) no *direction* was given to set up in advance an account either in favor of the Trinidad Bank or in favor of the draft holder, which of course, is what ordinarily is done when a credit is established in favor of somebody by a cable transmission or otherwise; and (*b*) no account *was* ever set up in favor of the Trinidad Bank or of the draft holder.

(3) On the contrary all the drafts drawn by all of the depositors of B. C. I. were credited in an omnibus Drafts Payable Account, and, as will be shown, the credit in the Drafts Payable Account "is entered in a folio under the name of the bank *whose account has been charged*" (fol. 350), in this case, under the name of K. N. & K.

Yet, it is from these very acts and circumstances that the respondent urges that there must be found an intention equitably to assign a specific fund for the payment of the draft drawn by Trinidad.

Not only is no such intention found in the mere acts themselves, *but on the contrary*, the record shows affirmatively and without contradiction that the entries were made in accordance with well recognized international banking practices existing for wholly different reasons.

*As a means of reimbursement—*National City Bank* vs. *Hotchkiss*, 231 U. S., 50, analyzed *infra*, p. 85.)

**Testimony of Dawson as to Reasons for Existence of "Drafts Payable Account."**

**Its Creation Independent of Drawing Service Contract.**

The reasons for the existence of the international banking custom, as appears from the *uncontradicted testimony of the expert witness Dawson*, about to be analyzed, are two-fold:

(*a*) That it was a convenient method of indicating to the drawee banker what his commitments were likely to be in the immediate future and thus enabled him to have liquid and available for immediate use enough capital to meet those commitments;

(*b*) That while the banker paid interest to his depositor on the balance in the latter's general account, no interest was paid on the amount of his funds credited to the Drafts Payable Account, and that the use of this latter balance without the payment of interest thereon between the time of its credit to the Drafts Payable Account and the presentation of the draft drawn by the depositor or under his protection constitued the foreign bank's compensation for its services in meeting the draft.

Ralph Dawson, Vice-President of the Guaranty Trust Company of New York, has had extensive experience in international banking for over 25 years (fol. 345), and has had experience in all branches of the foreign exchange business (fol. 340 *et seq.*). He is familiar with and has handled foreign exchange transactions, both in which the New York banks drew their own drafts upon foreign correspondents (fol. 345) and also involving the "protection of drafts by New York banks, bankers or trust companies on behalf of inland banks" (fol. 346).

At fol. 350 he testified:

> "The Witness.—The practice is to charge the current account of the client with the sum of money and carry it over into another account which is known on the ledgers of most banks as 'unpresented drafts drawn,' *where it is entered in a folio under the name of the bank whose account has been charged.*" (The "unpresented drafts drawn" account is the "Drafts Payable Account" referred to throughout this brief).

In other words, although B. C. I. debited K. N. & K.'s general account and credited the unpresented drafts payable account, the credit was entered in a folio, *not* under the name of the Trinidad Bank or the draft holder, *but under the name of K. N. & K.*, thereby indicating that the balance still belonged to K. N. & K. and was subject to their control.

The reasons for the existence of this custom at the present time were stated by Mr. Dawson to be as follows (fol. 357):

> "Q. How has that practice developed in modern times? A. Well, the practice has hung on in modern times, like a great many other practices, and has been availed of *as a means frequently of compensating a banker* for an account that would otherwise be troublesome and a loss. You have many accounts frequently that are active, which on bare balances in current accounts, are a lot of trouble, and a loss in handling that would not be worth while, but *there is always a non-interest bearing float that compensates you for the trouble you take.*
>
> Q. So that in reality *there are two reasons, are there not, generally assigned, namely, to put the drawee bank or banker in a position to meet the drafts which have been advised, and to enable him to use that fund as he may without paying interest thereon to the person who has the account?* A. *That is right.*"

And at fol. 370:

> "Q. That is, knowing how much the advised drafts are, you know how much money you have to keep as ready cash? A. Yes.
>
> Q. And you determine the amount of drafts which are to come from your general omnibus Drafts Payable Account? A. Yes.
>
> Q. That is, any day, looking at your Drafts Payable Account, you know how many outstanding advised drafts there are, how much that amounts to, and therefore, you know how much available cash you have to have in order to meet that draft? A. Yes."

And at fol. 373:

> "The Master.—And under the present system does the bank have the use of that money until the draft is presented for payment?
>
> The Witness.—Yes.
>
> By Mr. Goldmark:
>
> Q. They can lend it on the street? A. Yes.
>
> Q. That is, they could lend a sum equivalent to some one on the street, so that, at any moment, if the number of drafts which had been advised, which came in on a particular day, was more than the average number that came in on another day, you would always know at the beginning of the day how much money you needed from your Drafts Payable Account to meet outstanding drafts? A. Yes."

In addition to explaining the present practices and the reasons underlying them, Mr. Dawson testified as to the *origin of these practices*. He stated, in substance, that in the past when there were no Federal reserve banks, banks of rediscount or methods of suddenly raising cash, an international banker on being advised that his depositors had drawn drafts on him, would convert some of *his own* non-liquid assets into cash and hold the cash

ready to meet the obligation, namely, the payment of the drafts which his depositor had drawn (fol. 356). The respondent sought below to find in Mr. Dawson's testimony just referred to proof of an intention to assign a particular fund for the payment of a draft not yet presented.

The testimony only showed that in the times referred to by Mr. Dawson, before the existence of the present elaborate credit system, bankers found it necessary to convert enough *of their own assets* into cash so that they could conveniently meet their expected obligations. The cash so set aside was not however irrevocably appropriated by them to the expected obligations but was set aside, according to Mr. Dawson's testimony, purely as a matter of convenience (fol. 356).

**K. N. & K. at all Times Remained the Owner of and in Control of the Balance in the Drafts Payable Account for They Could Always Have Cancelled the Draft.**

It has been shown at page 17 *supra*, that if K. N. & K. retained control of their foreign balance, that balance cannot be deemed to have been irrevocably appropriated or equitably assigned to the respondent. That they *did* at all times retain such control is shown by the uncontradicted testimony of Dawson.

At folio 350 *et seq.* he testified:

> "Q. Is there also a general practice or custom with respect to the cancellation of advices after their receipt by the foreign bank and prior to the presentation of the draft for payment? * * * A. Yes, there is a custom.
>
> Q. What is that custom? * * * A. I take it the question means that the drawer bank wants to cancel a draft that has already been drawn and advised.

Q. Precisely? A. A communication of the fact of cancellation by any means he can avail himself of, cable, letter or anything else. Upon receipt by the drawee bank that such draft has been cancelled, a reversal entry is passed, taking the amount of such cancelled draft from the unpresented draft ledger and crediting it back into the current account."

He further testified (fol. 353):

"Q. And does that same custom prevail in the case of drafts drawn by inland banks, where the advice is by the New York bank? * * * A. Yes, because the foreign bank, the drawee bank, does not know the party who is drawing. * * *

Q. Is such cancellation ordinarily and customarily effected without assigning any reason? * * * A. The drawee bank acts entirely on the orders *of its client*.

Q. Which is the bank— A. Which is the bank that has the account on its books." (In this case K. N. & K.)

Despite the clarity of Mr. Dawson's testimony to the effect that "the drawee bank acts entirely on the orders of its client"—in the present case K. N. & K. and not Trinidad—the respondent urged below that Mr. Dawson's testimony showed that K. N. & K. could only cancel the draft where the inland bank had requested them to do so. The respondent rested its contention entirely upon Mr. Dawson's statement at folio 351 just quoted that the foreign bank would cancel an advice where "the *drawer* bank wants to cancel a draft that had already been drawn and advised."

It is clear, however, that at that stage of the examination no mention had yet been made of drafts drawn by one bank under the protection of another, as in the present case. Only the usual situation of the drawing of a draft on a foreign bank by the depositor himself was then being considered. Mr. Dawson's reply was

simply to the effect that in that usual situation the foreign bank would at all times cancel the advice at the request of the "drawer"—"drawer", under the circumstances then being considered, meaning the foreign bank's depositor.

The respondent disregarded in its argument below the subsequent testimony of Mr. Dawson in reply to questions by the respondent's own attorney where Mr. Dawson made it entirely clear that the foreign bank always accepted the instructions of its client-depositor whether that client had advised its own draft or the draft of an inland bank. Mr. Dawson's testimony at folio 368 is as follows:

> "Q. You made an answer to Mr. Goldmark to the effect that these cancellations were effected upon notification from the drawer, didn't you? A. No, sir, *from the client.*
>
> Q. Then I may have misunderstood you. A. *When the question was asked there was no question of a third party.*
>
> Q You mean the person who drew the draft, when you say client? A. *No, sir, I mean the name that is on the books of the drawee bank is the client or the owner of the funds.*
>
> By Mr. Goldmark:
>
> Q. *You mean the person who has the account in the bank?* A. *Yes, sir.*
>
> Q. *They cancel the advice at his request whether he is the drawer of the draft or whether he is the person who advised the draft drawn by somebody else?* A. *Yes, sir; at his order they will cancel the draft.*"

**The Forms Used for Cancellation.**

The fact that K. N. & K. at all times remained in control of their foreign balances and cancelled advised drafts at their will is further supported by the fact that

K. N. & K. had regular printed forms which they used to accomplish this result (Trustee's Exhibits 3 and 4, page 192). Those forms contained no reference to the fact that the cancellation was pursuant to the request of the inland drawer bank and very apparently the foreign drawee bank was not interested in that information. The foreign bank, the B. C. I., honored K. N. & K.'s instructions because it considered itself obligated only to K. N. & K. and recognized no obligation either to Trinidad or to the draft holder. It was not the practice in requesting the cancellation of advices of "protected" drafts to advise the B. C. I. that such cancellation was at the request of Trinidad or any inland bank (fol. 222). As Mr. Dawson clearly stated at folio 368 already quoted, the foreign bank only recognized the instructions of its own depositor whether that depositor was itself the drawer of the draft or whether the depositor merely advised and requested the protection of a draft drawn by somebody else.

In the light of the foregoing testimony there can be no doubt that K. N. & K. at all times remained in full control of all their balances abroad including the portions thereof credited to the Unpaid Drafts Account.

**Other Evidence Confirming Dawson's Testimony as to Custom.**

The existence of the international banking practice to which Mr. Dawson testified is also confirmed by the testimony of Mr. Schulze (fol. 327). On this phase of the question it is important also to note Mr. Schulze's testimony (fols. 400 to 402), that in cases where *dollar* drafts were drawn on the B. C. I. (as distinguished from drafts drawn in lire as in the case at bar), the amount thereof was not charged against K. N. & K.'s general account on receipt of the advice and was not credited to the

Drafts Payable Account, and that, therefore, inasmuch as the B. C. I. had the use of no credit without the payment of interest pending the presentation of the draft, it received a commission for honoring these dollar drafts. The application of the general custom testified to by Mr. Dawson, under which the B. C. I. looked only to its customer, K. N. & K., for instructions as to cancellation and recognized K. N. & K.'s sole control over their balances both in their general account and in the Drafts Payable Account, is confirmed by the testimony of Mr. Schulze (fols. 216-219) and 234-238). The absolute control of K. N. & K. over their balance with the B. C. I. has been clearly demonstrated.

Mr. Dawson's testimony is also supported by the facts *stipulated* at fol. 378 to the effect that the B. C. I. cancelled drafts drawn either by K. N. & K. or under their protection and that

> "This was done *without knowledge* on the part of the B. C. I. as to whether such draft or drafts were in the possession of the bankrupts, the drawer banks or third persons."

**D. The Conclusions from the Foregoing Facts Show that the Tests of the Existence of Equitable Assignment Have Not Been Met.**

The foregoing facts* establish the following propositions:

(1) There was no intention on the part of K. N. & K. or the Trinidad bank to assign any funds abroad, K. N. & K.'s sole obligation being to have the draft paid *at presentation*, as in the case of drafts drawn by K. N. & K. themselves, and thus see to it that Trinidad's obligation to its customer and the payee was performed. K.

*The errors of the Court below in interpreting the testimony are considered at page 42, *infra*.

N. & K. agreed to furnish sufficient funds as a *means* of enabling them to perform their obligation.

(2) *K. N. & K. did not direct B. C. I. to set up any particular fund* but simply directed the debiting of the drafts to their general account upon presentation. And *no fund was in fact set up* in favor of Trinidad or the draft holder or irrevocably appropriated abroad. The credit to the omnibus Drafts Payable Account was made, not in pursuance of K. N. & K.'s obligation under the Drawing Service, but pursuant to the well established international banking custom. The same practice was pursued with respect to drafts drawn by K. N. & K. themselves, although their issuance was *not* governed by the terms and conditions of the Drawing Service. This custom exists for reasons entirely independent of a desire irrevocably to create a fund.

(3) The final "debit" and the final "charging" were of course to take place when the draft was "protected" or "honored" by the B. C. I. and not before. Because of the reasons and *subject to the control* just explained K. N. & K. acquiesced in the general international banking practice of debiting their account and crediting Drafts Payable Account pending the presentation of the draft.

(4) The Trinidad bank did not agree to look alone to the fund abroad for the payment of the draft drawn by it, but desired and procured K. N. & K.'s general obligation "to protect" that draft when presented. *Does the respondent seriously argue that the intention underlying the Drawing Service as agreed to by the parties was that the large and small banks scattered throughout this country, which had no knowledge of foreign banks and bankers, were paying over their money to K. N. &*

*K., relying on the credit, solvency and responsibility of foreign correspondents in scattered communities throughout Europe, wholly unknown to them and chosen by K. N. & K.?* What the inland banks wanted was that their drafts drawn upon foreign bankers with whom they had no relations whatever and of whom they knew nothing, be honored. They did not want funds set up in innumerable places throughout Europe which would be there at their risk, awaiting the presentation of the drafts. If the reverse were true, every bank throughout the country which availed itself of the service of K. N. & K. or other New York bankers, affording a like service, would have to look solely to the foreign bank, and in the event of its failure or refusal to pay, loss would not fall on K. N. & K. but on the inland banks. Such a conclusion would be inconsistent with the stated purposes of the Drawing Service where the maintenance of foreign balances by the inland banks was said to be "undesirable." *K. N. & K. having chosen the correspondents abroad and being in touch with foreign banking centers could well accept the same risk of loss on "protected" drafts that they accepted in drawing their own drafts on the very same correspondents.*

(5) The balance with the B. C. I. was at all times at the risk of K. N. & K., inasmuch as they had assumed an absolute obligation to have the drafts paid on presentation, from which obligation they would not have been relieved by the failure of the B. C. I., with the consequent loss of their balance.

(6) It appears from the undisputed testimony of Mr. Dawson and Mr. Schulze and from the stipulations in the record (fol. 378) just referred to that both that portion of the balance standing on K. N. & K.'s credit on the books of B. C. I. and that portion credited in the

Drafts Payable Account, was at all times at the absolute control and disposition of K. N. & K. and that the B. C. I. looked only to K. N. & K. for instructions as to the disposition of both balances. That is, K. N. & K. always remained the creditor of B. C. I.

### E. The Errors of the Court Below.

The essence and underlying premise upon which the Circuit Court's conclusion rests is found in the first three paragraphs of its opinion (fols. 749-754) and particularly in the very first paragraph. *And that premise is erroneous.*

The Court's entire opinion rests upon its initial statement that (fol. 750):

> "Performance once executed was irrevocable, because there was no intimation of any right to revoke it, and because the continued liability of the bankrupts was not an equivalent of performance, as the event proved. An obligee is not exposed to the renewed hazard of performance, once the obligor has performed, nor may the obligor at his whim undo that which he once did in satisfaction of his promise. * * *"

The Court has in the statement quoted assumed the very conclusion which it worked around to again at the end of its opinion. Of course, if the crediting of the Drafts Payable Account abroad constituted "performance" by K. N. & K., the credit was irrevocable. But there is nothing to show that that was intended to be performance. The Court's construction of the words in the instructions from Trinidad to K. N. & K. to "protect on presentation" is contrary to the universally accepted meaning of the banking terms. Again the only directions to B. C. I. were to "protect" and to "honor" to the debit of K. N. & K.'s account. All of Dawson's testi-

mony as to the custom of creating the Drafts Payable Account abroad irrespective of any special contract, as to the reasons for that custom and as to K. N. & K.'s retention of control over the foreign balance even after the credit to the Drafts Payable Account, was dismissed by the Court at folio 766 as follows:

> "There remains the question of custom. The evidence went no further than to show a practice of reversing the credits when the draft was cancelled. That was natural enough, but it is quite another thing to do so while the draft is outstanding."

*The Court is simply and clearly in error. The evidence —the uncontradicted evidence—did go further.* The testimony of Mr. Dawson at folio 368, already quoted at page 37, *supra*, clearly shows that the foreign bank looked *only* to its customer for instructions relative to cancelling drafts and from the stipulation at folio 378, it appears that "this was done without knowledge on the part of the B. C. I. as to whether such draft or drafts were in the possession of the bankrupts, the drawer banks, or third persons." It further appears that B. C. I. cancelled drafts without being informed that the cancellation was made upon request of Trinidad (fol. 222). It is true that the Trustee conceded, folio 379, that K. N. & K. only *did* cancel advices when instructed by the inland bank to do so. But the foreign bank knew nothing of this; it looked only to K. N. & K.; the latter retained full control despite the Drafts Payable Account. That K. N. & K. never did cancel except on the inland bank's instructions, does not bear on the question of their control over the foreign balance; it simply indicates that K. N. & K. having been paid to protect a draft, never found it necessary to cancel a draft unless advised to do so. It does not indicate that they *could* not have done so.

Further evidence that the credit to the Drafts Payable Account was not intended as "performance" is found in the stipulation, at folio 383 that the B. C. I. took the same action with respect to drafts drawn directly by K. N. & K. as it did with respect to those drawn by inland banks under the Drawing Service and protected by K. N. & K. *The Court below entirely disregarded this fact.* K. N. & K.'s drafts were drawn pursuant to no special contract like the Drawing Service. K. N. & K. remained liable on them as drawers until they were paid. No "performance" other than payment was conceivably contracted for. Yet credits to the Drafts Payable Account were made for those drafts also.

While it overlooked the facts concerning the bankrupts' own drafts in this case, in its opinion in *In re Zimmerman* vs. *Forshay, Ex parte Gray,* 14 Fed. (2d) 527, the Court was presented with a case involving just that situation—a draft drawn by the bankrupts without a special contract, advised abroad, and the amount thereof credited to a Drafts Payable Account. *The Court in that case, in order to remain consistent with its holding in the present case, was forced to this remarkable position:*

> "Although it is not so proved, we think that we must assume that when on receipt of the advice, the drawee made the entries upon its books, it did so in pursuance of a pre-existing agreement with the drawers. At any rate it is proved that the drawee advised the drawers of what it had done, and there is no evidence that the drawers protested."

That is, the Court undertook to indulge in an assumption unsupported by any evidence, and directly contrary to the theory of the Drafts Payable Account fully explained *by the uncontradicted testimony* of the expert Dawson.

To support its initial assumption that the bookkeeping entries abroad constitued "performance" by K. N. & K. the Court argued, at folio 752 that:

> "If they (K. N. & K.) had meant to become guarantors, the relation and the word were familiar enough, and it seems to us incredible that they should not have said so more unequivocally."

The Court is confused. The Trustee has not argued that K. N. & K. were guarantors—that they obligated themselves to perform the obligation of another. K. N. & K.'s contract was *not* with the draft holder to have the draft paid if the inland bank drawer did not pay it. The draft holder knew nothing of K. N. & K.'s existence. Their name did *not* appear on the draft. K N. & K.'s obligation was single, direct and primary—an obligation to the drawer inland bank to see that the latter's draft was paid. That is no guaranty; it is a primary obligation which could not be discharged by the creation of a fund abroad. K. N. & K.'s obligation was to have the draft *paid; not to establish a credit for the drawer.*

**Summary.**

A. When the Circuit Court of Appeals held that the advice of the draft followed by the crediting of the amount in the Drafts Payable Account constituted "performance" by K. N. & K. and an irrevocable appropriation of the amount of the credit to the performance of the contract, *the Court was erroneously giving to a coincidence the effect of a contracted for result*—a coincidence because the same thing happened (1) in cases where K. N. & K. had not entered into a contract like the Drawing Service, i. e., where they drew their own drafts; and (2) in cases of other drafts than those drawn or protected by K. N. & K., i. e., in the *Zimmerman & Forshay* case. That the credit to the Drafts Payable

Account had nothing whatever to do with the Drawing Service Agreement between K. N. & K. and Trinidad Bank is further proven by the fact that there is nothing to show that the drawee bank ever knew of the existence of the Drawing Service contract, or that K. N. & K. had given it any instructions to charge their account in order to perform K. N. & K.'s obligation.

B. The *second* underlying error of the Court below is its failure to give effect to the universally accepted meaning of the terms "protect" and "honor" as used in banking transactions and as used in the documents here under consideration.

C. The *third* underlying error of the Court below is its failure to accept and give effect to *the uncontradicted testimony* of Dawson as to the history and purpose of the Drafts Payable Account. The Court failed, also, to give effect to the uncontradicted testimony that it was the universal practice and custom for the foreign bank to always recognize the instructions of its customer to cancel advices prior to the presentation of the draft and for the foreign bank to consider that the relation of debtor and creditor continued to exist between it and its depositor until the draft had actually been presented and paid, despite the advice of the draft and the credit into the Drafts Payable Account. **No stronger evidence of the existence and recognition of the custom and of the fact that the crediting of the Drafts Payable Account was not an irrevocable appropriation can be presented than the fact that both in the present case and in the Zimmerman & Forshay case, the instructions given by the two Receivers were honored by the foreign banks.** The drafts theretofore advised were cancelled and the amounts theretofore credited to the Drafts Payable Account were recredited to

the general account of the bankrupt and the entire balance remitted to the Receiver. *In the light of these facts, this Court should pause before it fails to give effect to the established practice of banks, the reasons for which are so clearly set forth in Mr. Dawson's testimony.*

The fourth error of the Court below was its conclusion that there had been an equitable assignment in favor of the *payee or subsequent holder of the draft*, as distinguished from the Trinidad Bank, the drawer. The Court granted Trinidad's reclamation petition on the theory that the Trinidad bank, upon taking up the draft, had acquired the holder's rights. That this was the basis of the Court's conclusion appears most clearly from its opinion in the case of *In re Gubelman, Ex parte Muntean* (C. C. A. 2d 1926), 13 Fed. (2d), 730, already referred to, where the Court, in distinguishing the present case, said at page 732:

> "We decided the drawer, having taken up a draft drawn under the same 'service contract', stood in the position of an equitable assignee. It is true that this depended upon the drawer's subrogation to the holder's right, but the facts were not the same as here."

The extent of the respondent's rights is therefore limited strictly to the extent of the rights of the holder of the draft. The Court overlooked the elementary principle that *there can be no equitable assignment or irrevocable appropriation before the assignee has been notified of the assignment and has expressly or impliedly assented thereto.** As has already been shown, there is no evidence or claim that the holder of the draft (upon which the name of K. N. & K. nowhere appeared) at any time had any knowledge of the provisions of the Drawing Service, of the creation or existence of the Drafts Pay-

**Pomeroy Eq. Jurisprudence*, Section 1281, *note*.

able Account, or indeed of the existence of K. N. & K. themselves.

The fifth error of the Court below was its failing to hold that, since the foreign balance remained at all times subject to the absolute and sole control of K. N. & K., the balance passed to the Trustee under Section 70 (3) and (5) of the Bankruptcy Act as "property which prior to the filing of the petition he (the bankrupt) could by any means have transferred * * *."

## F. Leading Cases on Equitable Assignments and the Tests as to Their Creation.

### The Noyes Case.

The case admitted by the Court below to be "more nearly akin" (fol. 763) to the present case than any other is *Noyes* vs. *First National Bank* (1st Dept. 1917), 180 App. Div., 162, affirmed *on opinion below*, 224 N. Y., 542.

There it appeared that the Rock Island Railroad Company had opened two special accounts in the defendant bank, which were designated on the books of the bank by the titles "Chicago, Rock Island & Pacific Railroad Company Coupon Account" and "Chicago, Rock Island and Pacific Railroad Company, No. 2 Account." The deposits in both accounts were credited on the books of the railroad company to an account entitled "First National Bank of New York Interest Account." It appeared from the book entries and vouchers made by the railroad company that the purpose of opening the special account and of making deposits therein was to use the money so deposited for the payment, from time to time as it might accrue, of the interest on two of the railroad company's bond issues. *Payment was made directly by the bank from said accounts as the coupons were presented.*

It is important to note that the form of the warrant of the Railroad Company does not appear in the opinion of the Court, but is set forth in the Record on Appeal and is quoted in the *Interborough* case, referred to hereafter, at p. 343 of the opinion as follows:

> "Chicago, Rock Island and Pacific Railroad Company. Warrant in Favor of First National Bank. Address: 2 Wall Street, New York City. August 29, 1905. For deposit in Coupon Account of C. R. I. & P. R. R. Company to meet 6 mos. interest due Sept. 1, 1905, on $17,331,000 of its 5% Bonds of 1913, $433,275.00."

Upon the receivership of the railroad company, the coupon holders claimed to be entitled to the special account as against the Receiver.

Judge Scott, speaking for the Appellate Division, in holding that the relationship created between the railroad company and the bank was simply that of debtor and creditor with respect to the special coupon account, clearly states the contentions of the opposing parties, the defendant's contention being in substance what is contended by the Respondent here.

*If the transfer of funds from a general to a special account, the making of appropriate entries on the corporate books, the issuance of a warrant specifically stating that it was for the payment of coupons, does not create a trust or other equitable interest in the fund thus specifically identified for that purpose in the bank, it is hard to see why in the present case the acts of the parties can lead to any other conclusion. In the Noyes case as in the present case, there were two separate accounts and yet the Court held that the funds in the account containing the specially identified credit were at all times subject to the control of the railroad and therefore, remained the railroad's funds and passed to its receiver.* As stated

in *Taussig* vs. *Carnegie Trust Co.* (1913), 156 App. Div., 519, *infra*, the opening of the two accounts "was a mere matter of convenience."

**The Erb Case.**

The *Noyes* case was recently followed in the Court of Appeals in New York in *Erb* vs. *Banco di Napoli*, 243 N. Y., 45 (1926). In that case, the Kingdom of Italy issued its bonds which provided on their face that principal and interest would be paid at the office of the Banco di Napoli in the City of New York. The coupons contained a like provision. The plaintiff lost three coupons, could not present them for payment, but nevertheless sued the Banco di Napoli for the amount thereof. The Court of Appeals held that there could be no recovery. The decision is peculiarly important because in the language of the Court of Appeals "The Kingdom of Italy had *provided funds* to meet its obligations," and it appeared from the agreed statement of facts "that the Kingdom of Italy has *supplied* the defendant with the *funds* wherewith to pay these coupons * * *." The New York Court of Appeals held nevertheless that the relationship between the Kingdom of Italy and the Bank in New York remained solely that of debtor and creditor, and that the plaintiff could not recover under the third party beneficiary doctrine. In speaking of the *Noyes* case, the Court of Appeals said:

> "The case of *Noyes* vs. *First National Bank of New York* (180 App. Div., 162; affd. 224 N. Y., 542) seems to be directly in point. There it was held that money sent to a bank to pay interest coupons and entered by the bank in a special account for this purpose did not create a trust in favor of the holders of outstanding coupons."

These cases are in principle indistinguishable from the present case and should be followed here. This court in

the recent case of *Empire Trust Co.* vs. *Cahan*, 71 L. Ed. 826, decided May 31, 1927, said:

> "It is very desirable that the decision of the courts of the United States and that of the highest court of the state where the business was done should agree* * *."

The Court below could only distinguish the *Noyes* case by saying that there "the funds were not credited to the bondholders on the books of the agent" (fol. 764). The implication is that in the present case, the fund abroad was credited on the books of the B. C. I. to the Trinidad bank or the draft holder. This is not so. The amount of the draft was credited only to an omnibus Drafts Payable Account "*where it is entered in a folio under the name of the bank whose account has been charged*" (fol. 350)—*in this case the name of K. N. & K.*

**The Interborough Consolidated Case.**

The decision of the Court below in the leading case of *In re Interborough Consolidated Corporation*, (C. C. A. 2nd, 1923) 288 Fed. 334 *certiorari* denied, 262 U. S. 752, is inconsistent with its present holding.

*Facts.* There the question was whether on the bankruptcy of the Interborough Consolidated Corporation a Coupon Account in a New York bank, set up for the payment of coupons under the Corporation's mortgage, was a trust fund, or had become subject to an equitable charge or lien, or had been equitably assigned, so that the holders of unpresented coupons which had matured could claim the fund to the exclusion of the general creditors of the bankrupt. The Court held that there had been no equitable assignment and that the balance in the Coupon Account must be considered a part of the bankrupt's general assets.

It appeared that at the time of the bankruptcy, the Corporation had on deposit with the Empire Trust Company a fund of some $431,000.00, said fund being in the account entitled "Interborough Consolidated Corporation — Interest on Interborough-Metropolitan 4½% Bonds," which had come into existence under the following circumstances: It had been the custom of the treasurer, shortly before any installment of interest on the bonds became due, *to withdraw from the general funds* of the Interborough *sufficient* funds to pay the installment of interest becoming due and to deposit them with the Trust Company, which entered on its books money so deposited in a special account entitled as aforesaid "Interborough Consolidated Corporation—Interest on Interborough—Metropolitan Company 4½% Bonds." *The balance in the account thus created was used solely for the payment of interest.*

Upon presentation of coupons at the office of the Consolidated checks were *drawn by the Interborough* upon the Empire Trust for the several amounts of the coupons presented. *The checks stated on their face that they were to be paid out of the fund for the payment of interest, entitled as aforesaid.* Similar checks were sent to holders of registered bonds. It appears further, from the District Court's opinion, 277 Fed. 249 (where a much fuller statement of the facts is set forth) that at a meeting of the directors of the predecessor company, the Interborough-Metropolitan, the president had stated that in order to facilitate the distribution of dividend, interest and bond payment, *it was desirable to create special deposit accounts by withdrawing from the general funds from time to time, funds sufficient to meet the requirements, each withdrawal to be accompanied by a check in accordance with the by-laws and "to comprise a separate and distinct deposit to cover the exact amount of a full interest payment."* On June 3, 1915, at a meeting of the

Board of Directors of the successor company, the Consolidated, a similar statement was made by the president of the Company.

*Holding.* On these facts the Circuit Court of Appeals held *that no trust, equitable lien or equitable assignment had been created and that the holders of outstanding coupons were but general creditors.*

In the present case, no contract of any kind was made by K. N. & K. with the draft holder, whom nevertheless the Court below found to be the equitable assignee. Nor is there any evidence that K. N. & K. ever lost control of the fund. The holding of the Court below in the present case is inconsistent with its holding in the *Interborough* case.

The lower Court's attempted distinction of its earlier decision in the *Interborough* case is along the same lines as its attempted distinction of the *Noyes* case.

> "There, the mortgagor did not establish a credit on which the bondholders might draw, but drew checks itself to pay the coupons" (fol. 763).

As was said with respect to the Court's comment on the *Noyes* case, K. N. & K. in the present case "did not establish a credit" on which anyone but themselves could have drawn.

**Summary of Noyes and Interborough Cases.**

It is to be noted that in the *Noyes* case, despite the fact (1) that the railroad company had set up a special coupon account, and (2) had transferred to that account certain funds, a portion of its balance, and (3) that the bank was authorized to pay out such moneys without further act of the depositor, and (4) upon the mere presentation of the coupons, nevertheless, this was deemed to be a mere method of procedure. The segregation of

the balance was held *not* to constitute an assignment, but to leave the money wholly within the control of the depositor with the result that it passed to its receiver. And in the *Interborough Consolidated* case it is to be noted that the coupon account was set up by special resolution and that it was stated by the president of the corporation that the purpose was to withdraw the moneys in the coupon account from the general account. *Yet in these two leading cases, it was held that there had been no equitable assignment and that the money was still subject to the control of the depositor and that the fundamental relationship between the bank and the depositor was not affected by the mere book entries.*

### G. Authorities Relied on by Respondent and Court Below Distinguished.

In *Fourth National Bank* vs. *Yardley*, 165 U. S., 634, there was an *existing* bank account in New York and when the owner of that account gave his check on the New York bank, he represented that there was a balance in New York and that *it, that very fund*, would be applicable to and available for the payment of the particular check. There was a present intention to assign, and in equity, a present assignment of that *specific bank account*. It was the *res* in New York that was in reality the subject of the contract, for as the court said:

> "If it was the *understanding* and *agreement* of the parties that an advance about to be made should be a charge on and be satisfied *out of a specified fund*, a court of equity will lend its aid."

The court found that that was the agreement and that the balance in the New York account was the *security* upon which the money was advanced. Certainly in the case at bar Trinidad did not seek security for performance of K. N. & K.'s promise.

In *Coates* vs. *First National Bank of Emporia*, 91 N. Y., 20, the Court held that there was an existing fund in the hands of the New York bankers, *which very fund* it had been presently agreed should be transferred from the Mastin Bank to the Emporia Bank in consideration of the payment by Emporia to Mastin of $5,000.00 The whole basis of that decision, as in the *Yardley* case, was that from all the circumstances of the case, it was concluded that the intention of the parties had been presently to assign *a specific existing fund* in another bank and that the delivery of the checks was simply the means of enabling the assignee to collect the assigned funds. That this is so, appears from the court's statement as follows:

> "In the case before us * * * there was an existing fund in the agent's hands and a distinct contract by the debtor with its creditor *to discharge the liability out of that fund* and to give directions for that purpose."

Such directions were given and of course the transaction thus became wholly executed and the Emporia Bank became a creditor of the New York bankers on their books and the Mastin Bank was discharged.

The same principle underlies *Muller* vs. *Kling*, 149 App. Div., 176, affirmed 209 N. Y., 239, namely the intention equitably to assign *a specific obligation*—the intention to contract respecting a *specific res*. Judge Miller, in his able opinion in the Appellate Division, points out that Muller, Schall parted with their money *on the faith and security of an existing debt or fund*, to wit, the obligation of Invinizio to Scholtz, which was to be collected by Damechy and applied upon the draft. The same view was expressed by the Court of Appeals, citing as authority the *Yardley* case. It hardly can be urged that this unusual case—in-

volving existing collateral security upon the faith of which the very purchase of the draft hinged—can have the slightest relevancy to the ordinary banking transaction involved in the present case, where no particular fund—no *res*—was involved, but merely an obligation on the part of K. N. & K. to provide "sufficient" funds at the time of presentment in the future as a method of "protecting" the draft.

In *Hackett* vs. *Campbell*, 10 App. Div., 523, there was admittedly an assignment of an existing indebtedness as between the assignor and the assignee, the only problem being as to whether or not the third person debtor had waived the contractual rights, which it had, to refuse to recognize such an assignment. The Court held that it had waived these rights and that it was bound to pay attention to the notice which it received of the admitted assignment from the assignor to the assignee.

*Dean (now Mr. Justice) Stone's Discussion.* In its brief below, respondent quoted from an article heretofore written by Mr. Justice Stone in 21 Columbia Law Review 507. The learned Justice, in speaking of the banker in the case of *Legniti* vs. *Mechanics and Metals Nat'l. Bk.* (1921) 230 N. Y., 415, said:

> "Had he actually acquired the credit and specifically appropriated it or a part of it to his undertaking for account of the plaintiff, a very different situation would have arisen and one on which the plaintiff might properly have based a claim that the credit so far as it was an unenforceable one was held by the banker in a fiduciary capacity for the plaintiff."

The *Legniti* case, however, had to do with the ordinary cable transfer transaction where the buyer contracted to buy and the seller to sell a foreign credit *which was clearly to be created in the name of the buyer and which the seller first had to "acquire."*

But the premise on which the writer's conclusion rests is that a credit be "specifically appropriated" to the banker's undertaking, for account of the customer. The discussion is not, therefore, conclusive here because the basic question is left unanswered—What facts show an obligation or intention specifically to appropriate a balance to the banker's obligation and what particular acts of the American banker in effect constitute an irrevocable appropriation without the retention of the right of control? These questions, of course, Mr. Justice Stone was not called on to consider within the scope of his discussion.

Neither did he consider the effect of Section 70 of the Bankruptcy Act referred to in Point III hereof. So that, in reality, his discussion does not advance the determination of the particular questions now before this Court, namely, *was* there here such an agreement and an intention to appropriate a particular fund, and was such appropriation here so irrevocably effected that the foreign balance did not pass to the trustee in bankruptcy.

## CONCLUSION TO POINT I.

*It is submitted therefore that the Court below erred in finding that the bankrupts had equitably assigned their credit in the "Drafts Payable" account before the drafts were presented for payment and actually paid by the B. C. I.*

## POINT II.

**The contract of the parties and the method of its execution did not establish ab initio a fiduciary or agency relationship between the Trinidad Bank and K. N. & K.**

### Preliminary Statement.

The Court below found in favor of the respondent on its second cause of action based on the theory of equitable assignment and found it unnecessary (fol. 769) to consider the first cause of action, i. e. that the bankrupts originally received money from Trinidad in trust.

If this Court reverses the decision of the Court below, it must pass on this first cause of action before dismissing the respondent's petition. It is hoped that the Court will express an opinion on this first cause of action in any event as it is the desire of all parties that the present case as a test case, dispose of as many other claims as possible.

If a fiduciary or agency relationship existed between the Trinidad Bank and K. N. & K., it must have grown from the undertakings of the parties, as found in the book called "List of Foreign Correspondents" (Claimant's Exhibit 1, fols. 418, *et seq.*) and in the book of "Forms and Advices" (Claimant's Exhibit 2, fols. 473, *et seq.*). Before analyzing those exhibits, and in order to determine whether K. N. & K. were mere agents or were independent contractors, the following principles established by the cases and authorities hereinafter referred to (*infra*, page 64 *et seq.*), must be borne in mind.

**A. Fundamental Legal Principles Underlying the Agency Relationship.**

(1) The mere fact that the word "agent" is used does not establish that relationship, if the legal obligations of K. N. & K. were in fact those of independent contractors.

(2) The tests usually applied to determine whether A. is the agent of B. are:

(*a*) Does B. control and direct A.'s activities or is A. merely employed to accomplish, with his own means and by his own methods, the ultimate result desired by B. and for which B. pays a consideration.

(*b*) Do A.'s services bring B. into contractual relations with third parties.

(*c*) Does the alleged principal or agent bear the risk of profit or loss from the transaction.

With these principles in mind, the following analysis of the contractual rights and obligations of the parties will show that the relationship here established between the parties was that of independent contractors.

**B. The Evidence of an Independent Contractor Rather Than an Agency Relationship.**

1. The introductory statement in the List of Foreign Correspondents, which explains the underlying purpose of the service, states that the maintenance of a foreign department by the inland banks involving the carrying of balances abroad "is undesirable" (fol. 419) and that K. N. & K. have aimed for many years to supply the wants of inland banks by extending to them "the privilege of using our *world-wide facilities* for carrying on a foreign exchange business" (fol. 419). It further states

that under the service offered, the inland banks "issue *their own drafts as principals* on the places mentioned in our List of Correspondents," and included in the book (Claimant's Exhibit 1) are 69 pages upon which are enumerated the list of foreign banks which might be drawn upon (fol. 472). The introduction also states (fol. 420) that upon receipt from the inland banks of proper advices and New York funds, K. N. & K.'s advices are sent abroad and "sufficient" funds for the payment of the draft provided to the drawee bank "by transfers of credit from our balance or otherwise."

2. "The Terms and Conditions" which follow the introductory statement (fols. 422, *et seq.*) provide:

> "Upon receipt of advice of draft, accompanied by adequate funds payable at par in New York, we shall promptly forward our advice of the same and provide the drawee with funds *sufficient* for the *payment* of the draft abroad, *by* a transfer of credit from our balance or otherwise, provided the draft is drawn on a bank named in our latest list of correspondents.
>
> "Under this arrangement, *our correspondents, in this country act as principals, and issue drafts in their own names, our name not appearing thereon.* In other words, we are employed merely as the agents of the drawers for the purpose of advising the issue of their drafts and providing the drawee bank with *sufficient funds* to cover their payment."

3. *The advice sent by Trinidad* of the drawing of the draft (Claimant's Exhibit 4, fol. 482), is one of the forms provided by K. N. & K. in the book of forms and advices (Claimant's Exhibit 2) and *must be read in conjunction with the "Terms and Conditions"* as it forms a part of the Drawing Service. In that form of advice appears the following instruction:

"8469B 69B

"Pursuant to the terms and conditions governing your drawing service we have sold draft, bearing the above number, dated, Trinidad, Colo., May 19, 1923.

"For Lit. 24,360.00 and shall thank you to *protect same upon presentation.*

"We remit herewith the sum of $1,191.20 @ rate

4.89 quoted { on Rate Card No. / in Telegram of / Telephone from } 18."

What the obligation of K. N. & K. was, under this instruction from Trinidad, depends upon the meaning of the direction "*shall thank you to protect same upon presentation.*" An obligation to "protect" a draft upon presentation is a personal general obligation to see that the draft is paid.

See

*Wabash St. L. & Pac. Ry. Co.* vs. *Ham* (1885), 114 U. S., 587, quoted *supra*, page 24 and other authorities there relied on.

It appears, therefore, that K. N. & K. was simply paid in advance for their own general obligation to see to it that the draft drawn by the Trinidad bank was paid *at presentation*, despite the fact that Trinidad had no account with the bank upon which it drew the draft.

4. The provision of Claimant's Exhibit 1 that K. N. & K. would provide the drawee "with funds *sufficient* for the payment of the draft abroad," is wholly inconsistent with respondent's theory that there was an obligation assumed by K. N. & K. to "forward" or to "remit" *the* fund or moneys which they received from Trinidad. *They could provide any funds to the foreign*

*bank at any time and by any means, as long as they were sufficient to cause the draft to be "protected" upon presentation.* The significance of the word "sufficient" as refuting the existence of a fiduciary relationship is shown in the *Beecher case*, p. 71 *infra*. Of course, as a practical banking matter, this result would be accomplished by K. N. & K. seeing to it that *at the time when the draft was presented*, K. N. & K.'s credit balance was sufficient to enable the foreign bank, in pursuance of the advice, to pay the draft, debiting the same to the K. N. & K. account. That would be the usual method and *means* of providing "sufficient funds."

5. It was not intended that, and the Drawing Service did not provide that Trinidad in any wise was to control or direct the means or method by which K. N. & K. was to perform their obligation. The complete freedom of method is evidenced by the provision that the sufficient funds could be provided by transfer of credit "or otherwise." This complete absence of control as to the method of effecting the result is a strong indication of the absence of an agency relationship. (See authorities, page 69, *infra*). It signifies rather the obligation of an independent contractor to carry out his contract by whatever means or method he sees fit, provided only he accomplishes the result contracted for and for which the consideration has been paid.

6. Paragraph (13) of the "Terms and Conditions" (fol. 434) states that there are furnished to the inland correspondents by card or telegraph quotation "the rates at which we are prepared to *sell or* provide for the payment of drafts." Thus there is considered under one head and in *pari materia* the rates and obligations with respect to the selling of K. N. & K.'s own drafts and the protection of or provision for the payment of

the inland bank drafts. Of course, there can be no doubt that as to the drafts issued by K. N. & K. as drawer, their only obligation was a general contractual one and not fiduciary. *In re Bolognesi* (C. C. A. 2nd, 1918) 254 Fed., 770. In the minds of the parties, the two transactions were deemed to be essentially similar. That the protection of the inland bank's draft was intended to produce no different liability than the sale of K. N. & K.'s own draft, is further evidenced by the provision of paragraph (14) of the "Terms and Conditions" (fol. 436). There it is provided that where an inland bank desired to sell a draft "on places not on our (K. N. & K.) list," such draft "should be bought" directly from K. N. & K., i. e., Trinidad should furnish the inland customer with a draft drawn by K. N. & K., and in such a transaction, *the same procedure as to payment by the inland bank to K. N. & K. and advice abroad was pursued as where Trinidad was the drawer of the draft.*

7. The provision at the end of Paragraph (13) of the Terms and Conditions (fol. 435) provides that if the inland bank sends insufficient funds, K. N. & K. has the option of refusing to send their advice abroad, or "we may advise the draft abroad and require payment to us by the remitter of the deficit at the correct rate." This indicates that even if K. N. & K. did not receive American Dollars equivalent to the foreign amount of the draft at the rate stated in the rate card, *it nevertheless could perform its obligation.* If it did so under such circumstances, it is clear that in performing that obligation, it could not be transmitting a fund, but must be employing its own credit.

8. The steps taken by K. N. & K. to perform their obligations in accordance with the instructions received

from Trinidad in Claimant's Exhibit 4, negative the contention now advanced by Trinidad that the obligation was to transmit a fund. In order to "protect the draft upon its presentation," K. N. & K. sent advices to the main office and branch office of the B. C. I. In the first form of advice, the B. C. I. was directed "*to protect* to the debit of *our* account the drafts as per particulars on the annexed copies," and in the second was sent the instruction "Please *honor* the above listed drafts, charging same to *our* account." The list included not only drafts drawn and advised by the inland banks under the drawing service, but also drafts drawn directly by K. N. & K. Here are no instructions to establish a credit for Trinidad or anyone else, or to transfer any moneys to Trinidad or anyone else, but solely the instruction to honor the draft, charging the same, to wit, the draft, to the K. N. & K. account. Here we have the usual every day banking transaction where the American banker advises his foreign correspondent that he has drawn a draft and requests him to honor it and charge it to the banker's account. *The situation only differs from the ordinary one, in that K. N. & K. in addition to protecting its own drafts, assumed an obligation to protect in a similar way the drafts of other drawer banks.*

### C. The Use of the Words "Principal" and "Agent" Are Not Controlling and Do Not Negative the Conclusion that the Parties Dealt as Independent Contractors.

To meet the cumulative effect of all the foregoing provisions showing the existence of an independent contractor relationship, the respondent relied below upon the use of the words "principal" and "agent" (Claimant's Exhibit 1 and 2, fols. 420 and 477). But the courts

have held in numerous cases that describing the relationship of parties as "partners" or as "agents," does not make them such, if their respective obligations, as a matter of law, do not establish such relationship.

*Beecher* vs. *Cosmopolitan Trust Co.* (1921), 239 Mass., 48; discussed at length, p. 71, *infra;*

*St. Regis Paper Co.* vs. *Hubbs &c. Paper Co.* (1923), 225 N. Y., 30;

*Sloan Shipyards Corporation* vs. *U. S. S. B. E. Fleet Corporation,* (1922), 258 U. S., 549;

*Casement* vs. *Brown* (1893), 148 U. S., 615;

*Employers' L. A. Corporation* vs. *U. S. S. B. etc. Corporation* (C. C. A. 2nd, 1923), 290 Fed., 182;

*Bendix* vs. *Staver Carriage Co.* (1912), 174 Ill. App., 589, 595;

*Petition of Williams* (C. C. A. 1st, 1924), 297 Fed., 696;

2 *Corpus Juris*, 423.

Mr. Justice Stone in 21 Columbia Law Review, page 521, said:

> "Nor is the nature of the banker's liability determined by referring to him as the 'agent of the depositor.' An agent may assume either a contractual or fiduciary liability with respect to money paid to him by the principal. The question is which kind of a duty did he assume, a question which can be answered only by inquiring as to the intention of the parties as evidenced by their acts interpreted in the light of the customary method of transacting business."

In *St. Regis Paper Co.* vs. *Hubbs & Hastings Paper Co.* (1923), 235 N. Y., 30, the court said at p. 36:

> "Even if for proper interpretation the contracts are to be read in the light of the collateral correspondence, it appears that the word 'agent' was used by the parties, not meaning 'one who acts for a principal,' *but in the not unusual sense of 'one with or through whom another transacts business'* and that the word 'commissions' was used for the equivalent of 'profits.' * * * The disposition of the case is, therefore, placed on broad fundamental grounds and not an narrow technicalities which might serve only to conceal the real obligations of the parties."

That the courts themselves have used the word "agent" in a loose sense appears from the leading case of *Moore* vs. *Potter* (1898), 155 N. Y., 481, where it was urged that an unpaid vendor who sold the merchandise for account of the buyer occupied a fiduciary relationship to the buyer, because the earlier cases in New York had said that one of the remedies of an unpaid seller was to sell the merchandise "as agents of the vendee." The court, in referring to the earlier use of the word "agent" said at p. 487:

> "*Clearly, the use of the words 'as agent of the vendee' was not intended as a determination that the relation between the parties was that which ordinarily exists between a principal who owns property and an agent* who may be authorized to manage or sell it. But *it is a general expression which has been somewhat inaccurately used to define the right of a vendor to make a resale and hold the vendee responsible for his loss.* It is quite manifest that a resale made under such circumstances is not made by the vendor strictly as the agent of the vendee, but he acts for himself in disposing of the property for the purpose of ascertaining the actual damages he may sustain."

In the *Fleet Corporation* cases, *Sloan Shipyards* vs. *U. S. S. B. E. Fleet Corporation* (1922), 258 U. S., 549,

a contract contained the provision that the Fleet Corporation was "representing the United States of America." It was urged, therefore, that the United States was the contracting party and that (a) it could not be sued in the District Court and that (b) it had a priority in bankruptcy. This Court held, however, that an examination of the contract as a whole showed that the Fleet Corporation contracted as a principal and independent contractor.

REASONS FOR THE USE OF THE TERMS "PRINCIPAL" AND "AGENT" IN THE PRESENT CONTRACT.

The reason for the use of the words "principal" and "agent" is clear if the provisions of the Service and the scheme employed are considered as a whole. It is fundamental to bear in mind that Trinidad, the inland bank, desired to appear to *its* customer as having the facilities of issuing *its own drafts* upon foreign banks, without being required simply to procure for the customer a draft from a New York banker. For this reason, the inland banks desired to "issue *their own* drafts *as principals*." That is, not to sell drafts of the New York bankers merely as the agent of those bankers. To accomplish the result sought, the scheme was that *K. N. & K. dealt only with the inland bank* and was to have no contractual relations either with the customer of the Trinidad bank in Colorado or with the payee of the draft which Trinidad drew. The only one to whom K. N. & K. was to have any obligation under the plan was the inland bank. Having, therefore, in the Drawing Service described Trinidad as the "principal" in the transaction in order to emphasize the fact that K. N. & K. had no relation with the customer in Colorado or the payee, and that the sole function of K. N. & K. was to have Trinidad's draft paid, it is stated: "in other words,"

K. N. & K. was the "agent" of Trinidad. Having em
ployed the word "principal" to define the relation o
the Trinidad bank to its customer, the correlative wor
"agent" was likewise employed. As in the *St. Regi*
*Paper Co.* case "agent" meant "one with or throug
whom another transacts business" and as in the *Flee*
*Corporation* cases "representing the United States o
America" did not mean an agency, so here the mer
use of the term "agent" does not of itself determine tha
K. N. & K. received the dollars from Trinidad in a fidu
ciary capacity.

### No Technical Agency.

That there was no technical agency or fiduciary rela
tionship follows from the nature of the obligation whic
K. N. & K. assumed. The application of such obligatio
to the tests which have been applied to determine whethe
a fiduciary relationship or that of an independent con
tractor has been established indicates clearly that n
fiduciary obligation was assumed by K. N. & K. Thes
tests have been stated above to be:

(*a*) Control of the means of performance;

(*b*) Bringing the principal into contractual relation
with the third party;

(*c*) The assumption of risk of profit and loss.

It already has been shown that Trinidad did not con
trol or direct the means by which K. N. & K. was to ac
complish the ultimate result for which the considerati
was paid by Trinidad in advance. K. N. & K. ha
"*world-wide facilities*" (fol. 419) for carrying on an ex
change business, and it was for the use of *its* facilitie
that the inland bank had contracted.

Mechem on "Agency" has stated the difference be

tween an agent and independent contractor in language which is peculiarly applicable to the present case. In Volume I, Mechem, Sec. 25, it is sated:

> "*Agency defined.*—The word agency, when used in its broad meaning as pointed out in the preceding chapter, *indicates the relation which exists when one person is employed to act for another.* In this aspect, it has, in our modern law, three chief forms: 1. The relation of principal and agent; 2. The relation of master and servant, or, in the more modern phrase, the relation of the employer and employee; and 3. *The relation of employer or proprietor and independent contractor.* All of these have some points of similarity but, at the same time, many aspects of real distinction."

And in Section 40, it is stated:

> "*How agent compares with independent contractor.*—Although all three are, in a large sense, agents, yet in ordinary legal usage the agent—and the servant also—is further to be distinguished from the 'independent contractor,' who is one who exercises some independent employment, in the course of which he undertakes supplying his own materials, service and equipment, *to accomplish a certain result*, not being subject, while doing so to the direction and control of his employer, but being responsible to him *for the end to be achieved* rather than for the means by which he accomplished it."

In other words, where the supposed "agent" is simply employed *to effect a result* and the supposed principal has no control over the method or means of performance, the relationship is that of independent contractors, although it may be stated that one person is employed to do something for the other as his "agent."

The *second test* has not been met, for it already has been shown that K. N. & K. was not employed to bring

the Trinidad bank into any contractual relations with third parties. In Dean Huffcut's valuable analysis of the principles of agency, at page 12 it is said:

> "An agent, therefore, is a representative who creates bifactoral obligations to which his principal is a party. These are usually contracts; but other concepts of the law fall within the classification, namely gratuitous undertakings, estoppel and deceit."

K. N. & K. was not employed to set up a credit in the name of Trinidad with the B. C. I. thus establishing a debtor and creditor relationship between the two. That is the very thing which the Drawing Service was intended to avoid. (See preliminary explanation, fol. 419). The B. C. I. assumed no obligation to Trinidad. It had no account on its books in favor of Trinidad. Its contractual relations remained solely with K. N. & K. to whose account it was directed to debit the draft upon its presentation. Even if there were an equitable assignment as the lower court has held, the assignee would be the holder of the draft and not the Trinidad bank.

The *third test* in determining the existence of an agency relationship is whether the alleged "principal" bears the risk of profit or loss in the transaction. If the "agent" bears the risk of profit or loss, he is an *entrepreneur* and is an independent contractor and not an agent. For discussion of this test, see 20 *Columbia Law Review*, 333; 22 *Columbia Law Review*, 576.

In the present case K. N. & K. undertook for a certain number of American dollars paid in advance to have a draft for a fixed amount of lire paid on presentation. K. N. & K. thereby assumed the risk of profit or loss, which might result from the decrease or increase in the value of the lire prior to the presentation of the draft. In doing so, they became *entrepreneurs* and in their rela-

tions to the Trinidad bank must have acted as principals and independent contractors.

In support of this conclusion is the stipulated fact at folio 70, that the rate on the day of the transaction was .0489 per lire and that "in fixing the aforesaid rate the bankrupts fixed an amount which was *estimated* by them to be sufficient to leave them a profit in the transaction."

**D. Leading Recent Cases Holding that the Relationship Established Was Not a Fiduciary One.**

The facts in *Beecher* vs. *Cosmopolitan Trust Co.* (1921), 239 Mass., 48 are in all material respects "on all fours" with those in the present case. On September 21, 1920, Beecher, the plaintiff, paid to the defendant trust company $500.00 and 30¢ postage for a "remittance order" for 24,270 Roumanian Lei payable to Mordchi Berman in Roumania. He received a numbered receipt called "remittance order," which contained the terms upon which the Trust Company agreed to remit. The material terms, and their similarity to the facts in the present case should be noted, were:

> "1. It is expressly agreed that The Cosmopolitan Trust Company *acts as agent only* for the sender.
>
> "2. The Cosmopolitan Trust Company, its correspondent or agent, is to forward the money from any European post-office to the required address. * * *
>
> "4. Refunds will be made at rate of exchange prevailing on date of refund."

On the day that the remittance order was issued the defendant Trust Company had a net credit balance with the foreign bank in Bucharest in the amount of 303,424.25 Roumanian Lei and an entry was made on the books of the Trust Company crediting the foreign bank

with 24,270 Roumanian Lei. (The entry thus made is of the same kind as that made by K. N. & K. in their so-called Memorandum Account, Trustee's Exhibit I, fol. 565). It appeared that it was the practice of the Trust Company to send advices of a remittance by every convenient sailing, and in accordance with this custom, on September 24th the Trust Company sent to the foreign bank by mail a letter of advice which read:

> "Please execute the following money orders *to debit of our account*,"

followed by a list of numbers of remittance orders, including the one issued to Beecher. (This is in substance the same as the advices, Claimant's Exhibit 6, fols. 487 *et seq.*, which state "Please protect to the debit of our account, the drafts as per particulars upon the attached copies," and Exhibits 6A to 6E which provide: "Please honor the above listed drafts charging the same to our account").

Upon receipt of Beecher's money, it was immediately placed with the general funds of the Trust Company. On the day after the advice was sent abroad, the Commissioner of Banks took possession of the Trust Company and by cable stopped payment by all foreign correspondents. The plaintiff demanded of the Trust Company and the Commissioner of Banks a refund of the $500.00 paid.

In holding that Beecher, the plaintiff, was but a general creditor of the Trust Company and that *no trust relationship was created*, the Supreme Court of Massachusetts in a unanimous opinion said:

> "Upon the foregoing facts the plaintiff contends that a trust attached to the $500.00 when that amount was delivered to the defendant trust company; that the company and the bank commissioner thereafter held that money as trustee,

and not as debtors, until the object for which the money was left with the defendant trust company was accomplished or it was returned to the plaintiff. As no contention is made that the trust arose through the fraud or bad faith of the company or its officers in receiving the money of the plaintiff with knowledge of its insolvency, the argument that there was a trust created by the delivery of the money to the defendant trust company for remittance must stand or fall upon the fact, or the absence of fact, that the money was received by the defendant trust company as a special deposit for transmission to its correspondent bank in Roumania. *Freeman's Bank* vs. *National Tube Works Co.*, 151 Mass., 413, 418, 24 N. E., 779, 8 L. R. A., 42, 21 Am. St. Rep., 461; *Farber* vs. *Dane*, 204 Mass., 412, 416, 418, 90 N. E., 859, 27 L. R. A. (N. S.), 808. Upon consideration of the receipts and remittance order, in the light of all the admitted facts, *we are of opinion that the obligation of the defendant trust company to the plaintiff created by the delivery of the money was not to hold that money separate and apart from its general funds until the remittance order should be presented and honored, but was a contract obligation based upon the payment of the money to have funds in Bucharest with a bank, which funds should be* **sufficient** *to insure the payment of the order on presentation. In a word, what the plaintiff accomplished by the payment of the money was the receipt of an agreement by the defendant trust company that it would procure and* **provide funds** *in Roumania to meet the order which it had sold and delivered to the plaintiff when that order should be presented for payment. It was not contemplated by the plaintiff that the money itself should be remitted or that the trust company should not use the money paid to it as its own pending the performance of the agreement with the plaintiff.* Its failure to perform gave rise to an action in contract, and not to a suit cognizable in a court of equity. *Taussig* vs. *Carnegie Trust Co.*, 213 N. Y., 627, 107 N. E., 1086; *Legnti* vs.

*Mechanics & Metals Nat. Bank of New York*, 230 N. Y., 415, 130 N. E., 597."

It is to be noted particularly that in the portion of the opinion italicized the Court emphasizes a distinction between the obligation to transmit a specific fund and an obligation "to *have* funds in Bucharest with the bank which fund should be *sufficient* to insure the payment of the order on presentation." The Court uses the word "sufficient" funds in the very sense in which it was used by the contracting parties in the "Terms and Conditions," namely, as representing a general contractual obligation to provide funds generally to meet the *order* in the *Beecher* case and to meet the *draft* in the present case upon their presentation.

It would seem that the claim of the existence of a trust relationship is completely disposed of by reference to the *Beecher* case alone, where the bank is specifically referred to as the "agent" of the sender and as K. N. & K. was in this case. Particularly is this so in the light of the fact that the *Beecher* case was cited with approval by the New York Court of Appeals in *Equitable Trust Co.* vs. *Keene* (1922), 232 N. Y., 290 at 295 and that its conclusions, in part, are predicated upon two recent New York authorities, the *Taussig* and *Legniti* cases, to which reference now will be made.*

In *Legniti* vs. *Mechanics & Metals National Bank* (1921), 230 N. Y., 415, the plaintiff wanted to transfer some money to Naples at once. He made his arrangements for this purpose with A. Bolognesi & Company, New York bankers, by purchasing a cable transfer from them. He received a bill which read "cable transfer to Italy to pay by cable to Banca Commerciale Italiana,

*See quotation from this Court's recent opinion in *Empire Trust Co.* vs. *Cohen*, quoted supra at p. 51, to the effect that "It is very desirable that the decision of the courts of the United States and that of the highest Court of the State where the business was done, should agree * * * ."

Napoli, advice to be forwarded by cable from New York (followed amount and value of exchange and terms of payment)." Plaintiff made payment to Bolognesi by check which was subsequently collected by the latter through deposit in its account with the Mechanics and Metals National Bank. The cable was never transmitted by Bolognesi and on the following day the latter made a general assignment for the benefit of creditors, which resulted later in the filing of a petition in bankruptcy. Bolognesi was indebted to defendant, the Mechanics & Metals National Bank, in offset of which indebtedness the latter wished to hold all balances remaining on deposit with it to the credit of Bolognesi. Said the Court at p. 423:

> "This action has been brought by Angelo Legniti upon the theory that A. Bolognesi & Co. became his agents for the sending of 18,000 lire to Naples, Italy, and that as the money was not sent, he may recover it from the bank into whose possession it can be traced. *The bank, he claims, holds it, charged with a trust to pay it to him; it is his money, he says, as he never lost title to it. We do not think there is evidence here of any trust.* * * * It will be noted that the bill presented to the plaintiff late in the afternoon of February 10th, above quoted, upon which the plaintiff parted with his money, stated that he, Mr. Angelo Legniti, bought of A. Bolognesi & Co. cable transfer to Italy—to pay by cable to Banca Commerciale Italiana. *This was not the case of a specific sum of American money being sent to Naples after being exchanged for lire. It was a case of* 18,000 *lire being needed in Naples and the purchase of A. Bolognesi & Company's credit* with the Banca Commerciale Italiana for this amount which credit was to be used by and for the benefit of Legniti. * * We are naturally impressed, as anyone must be, with the fact that the plaintiff gave his money to establish a relative value or worth in Naples and that the receiver kept the money and did not

deliver the value and that this money the bank now holds. Why should not the plaintiff get it back? *Upon the failure of A. Bolognesi & Co. many claims sprang into existence besides this of the plaintiff and it is the duty of the courts as far as possible to adjust these relationships according to well established principles, usages and customs.* • • •

"There were also many other claimants to the assets. TO ESTABLISH A RULE THAT IN A CASE LIKE THIS THE PLAINTIFF BECOMES A PREFERRED CREDITOR; THAT THE TRANSACTION IS IN THE NATURE OF A TRUST, AND THAT CHECKS DEPOSITED WITH BANKS UPON THE PURCHASE OF CREDIT ARE TRUST FUNDS HELD FOR CERTAIN AND SPECIFIED PURPOSES, IS APT TO LEAD TO MUCH CONFUSION, ESPECIALLY WHEN THOSE WHO HAVE DEVELOPED THIS METHOD OF DOING BUSINESS INTO A WELL ESTABLISHED CUSTOM HAVE NEVER TREATED THEM AS SUCH."

Also, at p. 420:

"There is a marked distinction between these transactions which I have just described and a direction to a bank or other person to transmit a certain specific sum of money to a person abroad. In such cases the bank or transmitter is the agent of the person paying the money, and until the money is sent holds it as agent or trustee for the owner. Such were the cases of *Musco* vs. *United Surety Company*, 132 App. Div. 300, and *People ex rel Zotti* vs. *Flynn*, 135 App. Div. 276. In these latter transactions, the intention of the payer is that the money he gives to his agent shall be sent abroad. It is the amount which he gives that is to be transmitted. How it is sent may be immaterial to him. If there be time, currency might be purchased and sent. If not, it may be transmitted in any form recognized in financial circles. It is not at all necessary that the sender or agent have credit in the place to which the money is to be sent. On the other hand, in the contract for credit it is not a specific sum which is to be sent but rather a specific credit which is to be pur-

chased. The amount paid varies with the market. The actual thing that is done by the sender in both of these cases may or may not be the same, but the practice of the merchants and banks has recognized a difference; so have the courts."

See also beginning of opinion containing long discussion on purchase of credit.

It is, of course, recognized that there is a factual difference between both the *Beecher* case and the *Legniti* case and the case at bar, in that in the former cases the customer dealt directly with the banker making the arrangements for payment abroad, while in the present case the respondent is not the purchaser of a draft, money order or cable transfer, but is an intermediate party contracting with the banker. This factual difference, however, is unsubstantial in that the obligation of the banker in both cases, toward the customer in the first instance and toward the inland bank in the present instance, is the same. In both cases it is an obligation to provide for the payment abroad, in the one case of the banker's own draft and in the other case of the draft issued by the inland bank. In both cases the underlying obligation is to provide "sufficient" funds abroad.

The principles underlying *Beecher* vs. *Cosmopolitan Trust Co.* and *Legniti* vs. *Mechanics Bank*, have been uniformly applied by the Federal and State courts. In fact no case in any jurisdiction has been found which in any wise questions their authority. *The principles underlying them have become a part of international banking transactions.* The leading additional cases are:

*Gravenhorst* vs. *Zimmerman* (1923), 236 N. Y., 22;

*Strohmeyer & Arpe Co.* vs. *Guaranty Trust Co.* (1st Dept., 1916), 172 App. Div., 16;

*Safian* vs. *Irving Natl. Bank* (1st Dept. 1922), 202 App. Div., 459, affd., no opinion 236 N. Y., 513;
*Samuels* vs. *E. F. Drew & Co.* (C. C. A. 2nd., 1924), 296 Fed., 882.

Cases involving letters of credit are also persuasive on this point.

In *Taussig* vs. *Carnegie Trust Company* (1st Dept., 1913), 156 App. Div., 519, affirmed no opinion, 213 N. Y., 627, the defendant Trust Company agreed to issue to plaintiff, who had a general account with the Trust Company, a letter of credit for £600 0 0 payable at the rate of £100 0 0 monthly in exchange for his agreement to have deposited with the defendant his pension of $500.00, also payable monthly. *A new account* was opened on the defendant's books termed "letter of credit account" to which were credited the various deposits of the pension and against which were charged the drawings under the letter of credit. The defendant bank failed at a time when the "letter of credit account" showed a credit balance of $2,920.82 to which the plaintiff claimed to be entitled as a preferred creditor. The court dismissed the complaint, saying at p. 521:

> "*The relation existing between the plaintiff and the trust company, at the time the latter became insolvent, was that of debtor and creditor.* The opening of the account and designating it 'letter of credit' was *a mere matter of convenience* to the trust company. It did not hold the money credited to that account in trust for the plaintiff and his interest was precisely the same in that credit as in the credit to the other account, and in neither case was he entitled to a preference. (Citing cases)."

The Court in the *Taussig* case relied upon *Kuehne* vs.

*Union Trust Company* (1903), 133 Mich., 602. That case is best analyzed in the language of the opinion:

"Hooker, C. J.—One, Milani of Detroit, contemplated a trip to Europe and had a conversation with the savings teller of the City Savings Banks, who advised him to take from said bank a letter of credit and who explained to him the advantages of doing so instead of carrying a large sum of money about his person. Milani subsequently brought to the bank a check upon it drawn by his employer for $500.00 and drew the money from another officer. He put $100.00 in his pocket and paid $400.00 to the aforesaid teller who issued to him a letter of credit for £80 0 0. Nothing further passed between them. * * * He (the teller) entered Milani's name on a signature card and wrote upon it 'guarantee for a letter of credit.' This was done to prevent any portion of said sum being drawn except as against the letter of credit, so that if a personal check of Milani had come to the bank not drawn on that letter of credit it would not have been honored. Milani drew a draft for $241.11 to the order of the plaintiffs, but before the check was presented and cashed by the plaintiffs the City Savings Bank failed. It is the petitioner's claim that the $400.00 paid by Milani for the letter of credit was paid and received by the bank for the specific purpose of meeting the obligation to petitioners under the letter of credit; that it was so treated by the bank; and since the fund in which it was placed was never depleted below the amount of this trust fund that petitioners are entitled to be paid in full. Upon the hearing the Circuit Court in Chancery held otherwise and denied the prayer of the petition. 'We think petitioner's position untenable. *Milani paid his money to the bank for an undertaking to pay him through others, on demand, a lesser amount. This obligation was honored by other bankers under some arrangement between the banks. This fund was never paid or received upon trust conditions and there is nothing to justify giving the priority*

*over other creditors.* The memorandum on the card was fully explained as precautionary merely, and not as giving Milani rights superior to those of any other depositor. The decree is affirmed.' "

The *Taussig* case and the *Keuhne* case involved moneys deposited with the bank to secure or indemnify the bank against the issuance of a letter of credit. They clearly held that money so deposited *though specially identified on the bank's records,* did *not* constitute a trust fund for a particular purpose and that the customer was not entitled to have a specific fund returned in the event of insolvency. *Those decisions go far beyond the necessities of the present case.*

**E. Principles Deducible from the Foregoing Authorities as to Existence of Fiduciary Relationship.**

It is evident that the foregoing recent cases have thoroughly considered in their various phases the principles underlying foreign credits and foreign exchange. The analysis of these cases has shown that the Courts have divided these transactions into three classes:

1. If A purchases from an American banker his draft in foreign currency upon a foreign bank and procures such draft from the American banker, he has procured what he desired in the negotiable obligation of the banker. The transaction is executed and A has become merely the owner of the banker's general obligation on the draft.

*In re Bolognesi* (C. C. A., 2nd, 1918), 254 Fed., 770;

*Legniti* vs. *Mechanics & Metals National Bank* (1921), 230 N. Y., 415.

2. If A goes to the American banker and pays him American dollars and the banker contracts to establish

a credit for a definite amount of foreign currency in a foreign bank in the name either of A or A's nominee, then the contract is not that a specific sum is to be sent abroad, but rather that a specific credit is purchased and what A gets is the banker's contract to establish that credit for that definite amount. This contract is executory as distinguished from Class 1, but like Class 1 results only in A obtaining the general obligation of the banker.

*Legniti* vs. *Mechanics & Metals National Bank* (1921), 230 N. Y., 415;

*Gravenhorst* vs. *Zimmerman* (1923), 236 N. Y., 22;

*Beecher* vs. *Cosmopolitan Trust Co.* (1921), 239 Mass., 48.

*American Express Co.* vs. *Cosmopolitan Trust Co.*, 239 Mass., 249;

*Foreign Trade Banking Corporation* vs. *Cosmopolitan Trust Co.*, 240 Mass., 413;

3. If A goes to a New York banker and directs the banker to transmit a certain specific sum of money to a person abroad the banker is the agent of the person paying the money and until the money is sent will hold it as agent or trustee for the owner. In this class the intention of the payer is that the money he gives to his agent shall be sent abroad. It is the amount which he gives which is to be transmitted.*

*Legniti* vs. *Mechanics & Metals National Bank* (1921), 230 N. Y., 415;

*It is suggested that in this class of cases also, the promise of the banker is the real consideration for the payment and the customer relies alone upon the general credit of the banker. Therefore, it may well be that even in this class of cases the relationship should be held non-fiduciary as it is in England. See Mr. Justice Stone's comments, quoted at page 84, *infra*.

*Musco* vs. *United Surety Company*, (1st Dept., 1909), 132 App. Div., 300, (N. Y.); *People ex rel Zotti* vs. *Flynn* (1st Dept., 1909), 135 App. Div., 276, (N. Y.).**

The difference between the transactions in Classes 2 and 3 is this: that in class 2 where the establishment of a credit is contracted for the banker undertakes to establish a credit for a definite amount in foreign currency and thus assumes the risk of profit or loss from the transaction, inasmuch as the consideration received by him from his customs has been fixed. In Class 3, on the other hand, the transmission case, in the language of Judge CRANE:

> "it is the amount which he (the customer) gives that is to be transmitted."

The banker assumes no risk of profit or loss, he undertakes to establish no definite credit in foreign currency, but undertakes only to pay to the customer's nominee the foreign equivalent of the amount received in dollars. This distinction is recognized in the opinion of the New York Court of Appeals in the *Leguiti* case where Judge CRANE, p. 420, says:

> "There is a marked distinction between these transactions which I have just described [a cable transfer or contract to establish a foreign credit—Class 2, *supra*] and a direction to a bank or other person to transmit a certain specific sum of money to a person abroad [Class 3, *supra*]. In such cases the bank or transmitter is the agent of the person paying the money, and until the money is sent holds it as agent or trustee for the owner. Such

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**Mr. Justice Stone's comment on this 1st case is: "It is difficult, therefore, to interpret the undertaking of the banker in that case as being anything more than a contractual obligation to procure a foreign credit for the depositor by the usual methods of exchange" (P. 521 of his article).

> were the cases of *Musco* vs. *United Surety Company* (132 App. Div. 300), and *People ex rel Zotti* vs. *Flynn* (135 App. Div. 276). In these latter transactions the intention of the payer is that the money he gives to his agent shall be sent abroad. *It is the amount which he gives that is to be transmitted. On the other hand, in the contract for credit it is not a specific sum which is to be sent but rather a specific credit which is to be purchased.* The amount paid varies with the market. The actual thing that is done by the sender in both of these cases may or may not be the same, but the practice of the merchants and banks has recognized a difference; so have the courts."

The decision in the *Leguiti* case has been regarded as a landmark by those engaged in the international exchange business. The principles it lays down have been accepted by traders in exchange and by the Courts of sister states. No claim has been advanced that those principles in any wise lead to an injustice. On the contrary it must be evident that an attempt to make an international banker or dealer in foreign exchange a fiduciary upon every occasion that he contracts to sell his foreign credit would lead to endless confusion in the banking world. For this reason counsel for New York bankers were granted leave to and did file briefs *amici curiae* in support of the argument of the Mechanics & Metals National Bank in the *Leguiti* case. All of such counsel earnestly urged that the establishment of a rule under which an agreement to sell a foreign credit would be construed as imposing a trust upon the dealers would be a great hindrance to American banking.

Mr. Justice Stone, in the article already quoted on "Some Legal Problems Involved in the Transmission of Funds," 21 Columbia Law Review, 507, showed his concurrence with the conclusion reached in the recent cases relied upon herein by saying (page 522):

"The great volume of litigation which has sprung from this simple banking transaction in the United States as contrasted with the English experience can only be attributable to the disposition of the courts in this country to impose on an important class of business transactions, a rule of law which does not conform to established business practice, and is not adapted to the economic needs of the business community.

"*The recent decisions of the courts of New York and New Jersey in the case of foreign exchange holding that the obligation of the banker is contractual only, evidence a more just appreciation and exact appraisal of the importance of the method of conducting the banking business in determining what the undertaking of the banker is.* **The principle of decision in those cases ought to be extended and applied generally to those cases where bankers undertake to effect payments of money for account of their customers in the ordinary course of the banking business whether the exchange element is present or not.**

"*The extension of the rule in the Legniti case generally to all cases of deposits of funds with a banker for transmission where there is no stipulation that the banker shall keep the deposit segregated as a trust fund, would not in any way limit the application of the rule that, when property other than current funds is received by the banker for account of his customer, it is to be treated legally as a quasi-trust fund.* We have already seen that paper entrusted to a banker for collection is so held by him although he is treated as only a debtor for the proceeds when collected. Bankers do not customarily use such property in their general business as bankers hence there is no custom or practice to rebut the common law presumption that such property is received in a fiduciary capacity."

As already shown the Massachusetts Supreme Court in the *Beecher* case concurred in the foregoing views.

**F. Obligation of K. N. & K. Even Less Susceptible of Interpretation as a Fiduciary Obligation than Bankrupt's Obligation in Legniti and Beecher cases.**

In the *Legniti* and *Beecher* cases, the bankrupt's obligation was to establish a credit for or to make a payment to a third person in foreign currency and it was held that the American dollars paid to the banker were not received in a fiduciary capacity. Those cases are surely much more analogous to the remittance cases classified under Class 3, *supra*, and relied on below by the respondent, than was K. N. & K.'s obligation here. That obligation, as already shown, was not to establish a credit for or make a payment to a third party, but was, in its essence, solely to see to it that K. N. & K. *themselves* had a sufficient credit balance with the B. C. I. at the time of the presentation of the draft, to the debit of which the draft could be paid in pursuance of the directions contained in K. N. & K.'s advice (Claimant's Exhibits 6 and 6D). It was in the consideration of this executory promise that the American dollars were paid in advance by the Trinidad Bank.

**G. The Hotchkiss Case in this Court Has Clearly Recognized the Principles Underlying the Trustee's Contentions.**

This Court has laid down in clear language the distinction between the line of cases relied upon by the respondent in the lower courts, and the rule applicable in the present case, by pointing out that for a deposit of funds to constitute a trust, *it must be intended not merely that the depositor's balance should be increased by that amount in order to enable it to carry out its contract obligations, but it must be intended that the very fund deposited "should be appropriated specifi-*

*cally" for the purpose indicated by the depositor.* In *National City Bank* vs. *Hotchkiss* (1913), 231 U. S., 50, a bank sought to retain as against the trustee in bankruptcy of a stock broker certain securities which the bankrupt had delivered to the bank on the eve of the bankruptcy. The securities had been obtained by the bankrupts through the use of moneys which had been loaned to them by the bank for that purpose, which funds, however, had been placed to the general credit of the bankrupts, and with the knowledge of the bank, was subject to the absolute disposition of the bankrupts. In holding that the bank could not retain the securities which had been procured by the bankrupts by use of the funds thus made available, Judge HOLMES said at p. 56:

> "In dealing with transactions of this kind, we may go far in giving them any form that will carry out the mututally understood intent * * *. *But if the intent was doubtful or inconsistent with the legal effect of dominant facts, it must fail.* * * * So that, even if we take it as a corollary of what was understood, that the use of the clearance loan was expected to enable the firm to repay the loan, it *does not appear to have been expected that the proceeds should be appropriated specifically to that end, but simply that the addition of such proceeds to the general funds of the firm would enable the latter to pay within the time allowed.*"

**Conclusion as to Point II.**

It is submitted, therefore, that this Court must hold that there was no trust with respect to the $1,191.20 which was sent to K. N. & K. with Claimant's Exhibit 4 (fol. 482), but that K. N. & K. received it solely as independent contractors and as payment in advance for the obligation of K. N. & K. to "protect" the Trinidad

draft "upon presentation." The dominant purpose of the Drawing Service was to enable Trinidad to avail itself of the world-wide credit facilities *of K. N. & K.* The latter were obligated, *not* to forward or remit any particular fund, but to employ their facilities already existing to provide the B. C. I. "with sufficient funds" (whatever their source) at presentation to pay the draft to the debit of K. N. & K.'s own account, *just as in case of drafts drawn by K. N. & K. themselves.*

## POINT III.

**Under Section 70a (3) and (5) of the Bankruptcy Act, the debt from B. C. I. to K. N. & K. vested in the Trustee as of the date of the filing of the petition in bankruptcy. The rights of the parties became fixed upon that date and the subsequent acts of the Receiver cannot change those rights. But the subsequent acts of B. C. I. are most persuasive evidence of the soundness of the Trustee's contentions.**

The respondent attempted to obtain comfort from some of the letters and cables interchanged between the receiver and the B. C. I. after the filing of the petition. Those communications simply set forth the bookkeeping mechanics necessary to effect the payment to the receiver. If they have any effect, they and their results are *most pursuasive evidence of the fact* that the B. C. I. recognized K. N. & K. as its creditor and as the owner of all balances in the Drafts Payable Account and in the general account even at a time when it was, of course,

aware of the fact that conflicting claims would, no doubt, be advanced in view of the bankruptcy proceeding.*

Irrespective of this, however, the rights of the parties were fixed as of the date of the filing of the petition in bankruptcy. It has been shown that on that date no trust had been created, nor had the money in the Drafts Payable Account been equitably assigned, but on the contrary remained the property of and subject to the control of K. N. & K. The fact that control, which carried with it the ability to transfer, remained in K. N. & K., establishes that power in the bankrupts which is referred to in Section 70-a (3) and (5) of the Bankruptcy Act, and resulted in the Trustee's getting title to all of the balances with the B. C. I., including those credited to the Drafts Payable Account *as of the date of the filing of the petition in bankruptcy.*

*Everett* vs. *Judson*, 228 U. S., 474;
*Fairbanks Shovel Co.* vs. *Wills*, 240 U. S., 642, 649.

These were balances which the bankrupts "could by any means have transferred" and they accordingly were property owned by the bankrupts at the time of filing the petition which vested in the trustee in bankruptcy in pursuance of subdivision a(5) of Section 70 of the Act.†

*It already has been noted that the foreign bank involved in the *Zimmerman & Forshay* bankruptcy, 14 Fed. (2) 527, also returned balances credited to a Drafts Payable Account.

†Section 70 of the Bankruptcy Act provides:

"(a) The trustee of the estate of a bankrupt, upon his appointment and qualification, and his successor or successors, if he shall have one or more, upon his or their appointment and qualification, shall in turn be vested by operation of law with the title of the bankrupt, as of the date he was adjudged a bankrupt * * * to all * * * (3) powers which he might have exercised for his own benefit, but not those which he might have exercised for some other person; * * * (5) property which prior to the filing of the petition he could by any means have transferred or which might have been levied upon and sold under judicial process against him * * *."

By Section 47-a (2) of the Bankruptcy Act, the trustee is endowed with the rights and remedies of a creditor, "armed with process." He has all the rights of an attaching or levying creditor and clearly the fund in the B. C. I. could have been attached prior to the bankruptcy by any creditor of K. N. & K., just as in the *Eastman Kodak* case, *supra*, p. 19.

The life insurance cases holding that, where an assured reserves the right to change the beneficiary, the surrender value of the policy passed to the assured's trustee in bankruptcy and that the beneficiary named in the policy has no rights, despite the fact that the beneficiary was not changed prior to bankruptcy, are the familiar cases interpreting the foregoing bankruptcy section.

> See *Cohen* vs. *Samuel* (1915), 245 U. S., 50.

## POINT IV.

**The general object of the Bankruptcy Laws is to afford equality among all creditors remaining unpaid at the date of the bankruptcy and in order to obtain equitable relief or to establish a right to specific funds, the Courts have been strict in demanding that the claimant's right be founded upon the clear intention of the parties without vagueness or uncertainty. The respondent here has failed to sustain that burden.**

In *Westinghouse Electric & Manufacturing Co.* vs. *Brooklyn Rapid Transit Company* (C. C. A., 2nd, 1920), 263 Fed., 532, 536, the Court said:

> "In order to obtain equitable relief, or to establish an equitable lien, the courts have been strict in demanding that, as a condition of such enforcement, the intention of the parties should be clearly found from the expression of their contractual relation as found in the contract, and it must appear that there is no vagueness or uncertainty as to the terms or substance of the agreement."

See also

> *In re Stiger* (C. C. A., 3rd, 1913), 209 Fed., 148, 155.

It is evident, therefore, that one claiming priority, a lien or title to a specific fund which has come into the possession of the trustee, has the burden of proving his prior rights in accordance with recognized legal principles.

Has this respondent established a right to reclaim founded "upon the clear intention of the parties without vagueness and uncertainty?"

**The Vagueness of Respondent's Case.**

The fact that throughout this proceeding the respondent has declined to indicate who it claimed to be the alleged assignee of the fund—itself or the payee of the draft—is alone most persuasive evidence of the absence of any definite contractual obligation to set up a fund in favor of anybody. If even with the aid of astute counsel, and before the lower Court spoke, the inland banks could not determine whom they claimed to be the equitable assignee, can it be said that the respondent's case is without "that vagueness or uncertainty" which is required to give it a preference over other creditors.

It hardly needs citation of authority at this late date to establish the proposition that the general object of

the bankruptcy laws is to afford equality among all creditors remaining unpaid at the date of the bankruptcy, and that in the distribution of a bankrupt estate, equality is equity.

*In re Tindal* (D. C. S. C., 1907), 155 Fed., 456;

*In re Fowble* (D. C. Md., 1914), 213 Fed., 676, 681.

## POINT V.

### In Conclusion.

In conclusion it is respectfully urged that the respondent, and indirectly the 200 other inland banks, have failed to show that they stand in any different position from any other ordinary creditors of the bankrupts who purchased drafts or cable transfers and have failed to show that it is entitled to be paid its claim in full to the detriment of the other creditors. It is further urged that it has failed to establish the existence of any trust or fiduciary relationship, or the assignment of any specific fund whatever. *The inland banks contracted upon the faith of the credit of K. N. & K. as did thousands of other creditors whose claims have been filed with the trustee. Neither in law or in equity are they entitled to preferential payment out of the assets here for distribution.* Equality is equity.

Finally, the following language of the New York Court of Appeals in the *Leguit* case, 230 N. Y., 415, 424, is peculiarly applicable:

> *"There were also many other claimants to the assets. To establish a rule that in a case like this*

*the plaintiff becomes a preferred creditor; that the transaction is in the nature of a trust, and that checks deposited with banks upon the purchase of credit are trust funds held for certain and specified purposes, is apt to lead to much confusion, especially when those who have developed this method of doing business into a well-established custom have never treated them as such."*

**The decree of the Circuit Court of Appeals should be reversed and the respondent's reclamation petition should be dismissed.**

Respectfully submitted,

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Supreme Court, U.
FILED
DEC 6 1927
CHARLES ELMORE CROPLEY
CLERK

# Supreme Court of the United States

OCTOBER TERM, 1927.
No. 130

THE EQUITABLE TRUST COMPANY OF NEW YORK, as Trustee in Bankruptcy of KNAUTH, NACHOD & KUHNE,

*Petitioner,*

*against*

THE FIRST NATIONAL BANK OF TRINIDAD, COLORADO,

*Respondent.*

## BRIEF FOR PETITIONER IN ANSWER TO BRIEF FILED BY FIDELITY TRUST COMPANY OF NEW YORK AS AMICUS CURIAE.

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Of Counsel.

# Supreme Court of the United States

OCTOBER TERM—1927.

| | |
|---|---|
| THE EQUITABLE TRUST COMPANY OF NEW YORK, as Trustee in Bankruptcy of Knauth, Nachod & Kuhne, Petitioner, *against* THE FIRST NATIONAL BANK OF TRINIDAD, COLORADO, Respondent. | No. 130 |

## BRIEF FOR PETITIONER IN ANSWER TO BRIEF FILED BY THE FIDELITY TRUST COMPANY OF NEW YORK AS AMICUS CURIAE.

The Fidelity Trust Company of New York by leave of this Court has filed a brief *amicus curiae* in which it seeks to sustain the conclusions of the court below, but because of the necessities of its case, seeks to sustain those conclusions upon grounds different from those advanced by the Circuit Court of Appeals and different from those urged by respondent.

The facts with respect to the reclamation claim of the Fidelity Trust Company differ from those with respect to the Trinidad Bank claim, in that the English bank upon which the Fidelity Company drew its draft, unlike the Italian Bank, did not debit the amount of the

draft to K. N. & K.'s account when receiving the latter's advice of the drawing and did not maintain a "Drafts Payable Account," to which it would credit drafts advised but not yet presented. The English bank, it appears, only debited K. N. & K.'s account upon the presentation and payment of the draft. Being unable, therefore, to advance the argument that the charging of the advised draft to K. N. & K.'s general balance and crediting it to the omnibus Drafts Payable Account constituted an equitable assignment, the Fidelity Trust Co. is driven to advance the following arguments:

(1) That the mere mailing of the advice by K. N. & K. of the drawing of the draft by Fidelity Trust Co. and the mere acknowledgment of that advice by the English Bank constituted an irrevocable appropriation or assignment of an aliquot portion of K. N. & K.'s foreign balance which by some means this claimant will trace into the hands of the Trustee in Bankruptcy; that the book entries abroad were not essential to the completeness of the equitable assignment; and that the existence of an assignment or trust depended upon the acts of the parties to the Drawing Service and not that of the foreign bank.

(2) That the draft, or more properly speaking, the check, drawn by the Fidelity Trust Co. which directed a foreign bank "to pay from balance against this check" since it was drawn under K. N. & K.'s protection—itself constituted an assignment by K. N. & K. of a part of K. N. & K.'s deposit with the foreign bank.

(3) That the American dollars paid to K. N. & K. by the Fidelity Trust Company were to be applied to a particular purpose and were received initially and held in a fiduciary capacity.

## POINT I.

**The mailing of the advice by K. N. & K. of the drawing of the draft by Fidelity Trust Company did not constitute an irrevocable appropriation by K. N. & K. of any res which has come into the possession of the trustee.**

The sending of a letter of advice or letter of instructions is the usual practice in connection with the drawing of drafts and checks in international banking.

*Eastman Kodak Co.* vs. *National Park Bank*, 231 Fed. 320, affirmed no opinion (C. C. A. 2nd) 247 Fed. 1002;

*Beecher* vs. *Cosmopolitan Trust Co.*, 239 Mass. 48;

*Hopkinson* vs. *Forster*, L. R. 19 Eq. 74.

In the *Eastman Kodak* case and in *Hopkinson* vs. *Foster*, it was held that the advice did not constitute an assignment of any fund, and in the *Beecher* case the fact that there was such an advice was ignored in denying recovery. In the *Eastman Kodak* case, a draft or check was drawn upon a balance in the National Park Bank in New York and on the same day that the check was drawn, the foreign depositor sent a letter to the Park Bank which read as follows:

**Dear Sirs:**
**Please protect our checks for**
**$75.00—c o American Electric Railway Association.**
**$30,000.00—c o Bankers Trust Company a c Eastman Kodak Company.**

---

**$30,075.00 by the debit of our account."**

Before the check was paid, the drawer's balance in the Park Bank was attached. The drawer then went into bankruptcy and the holder of the draft claimed that the attachment must fail because the funds of the drawer to the amount of the advised check was a trust fund which had been equitably assigned, and, was therefore not subject to attachment. This argument was rejected and the general rule applied that the check itself did not constitute an assignment of the fund—and that the letter of advice did not change the result. Judge Learned Hand said:

> "Courts have no doubt often gone to some lengths to interpret the surrounding circumstances as indicating an agreement to assign, but in no case like this, when *the check was neither upon a specific fund nor for the whole amount of the fund*. The only facts to change the rule are that simultaneously with the check went an advice to the drawee as follows: 'Please protect our checks for $30,000 c/o Bankers Trust Co. a/c Eastman Kodak Co. by the debit of our account.' This is no more than the *common letter of advice* which frequently goes along with a foreign check; *it does not create an assignment*. *Aetna National Bank* vs. *Fourth National Bank*, 46 N. Y., 82, 7 Am. Rep. 314; *Hopkinson* vs. *Forster*, L. R. 19 Eq. 74. This is indeed alleged to have been the usual practice between the parties, and as such it cannot well have been meant to create an assignment. If so, the bank would at its peril have been obliged to keep a list of the advices in the order of their priority. To have paid out a later check, when advice had been received of the issuance of an earlier check, would have exposed the bank to a suit unless the account was good for all. No bank would consider a customer's business which was to be done in such terms. It pays checks as they are presented, and receives advices in the case of foreign depositors only for the purpose of identifying the items as they arrive. They serve

as a safeguard to the validity of the paper when the business is done at long range * * *.

"I think it an extremely pernicious thing to throw doubt upon the scope of doctrines governing negotiable paper which, though a mere skeleton of expression, is among the most useful inventions of mankind. *To seek too readily for exceptions from the well settled rules upon this branch of the law in pursuit of a supposed equity, which incidentally does not exist here, is an evidence of insufficient understanding of the economics of finance and their immense value to industry.*"

The Fidelity Trust Company attempts to avoid the obviously sound conclusion reached in the *Eastman Kodak* case by pointing out an alleged distinction in fact, namely, that in the present case the draft was drawn by the Fidelity Trust Company and the advice abroad was by K. N. & K. in pursuance of a contract. That is, it is argued, that although concededly the mere sending of an advice of the drawing of a draft does not effect an assignment or an irrevocable appropriation, the sending of such advice pursuant to a contract *does* constitute such an assignment or irrevocable appropriation.

It is to be noted that the form of advice sent in connection with Trinidad's draft and presumably in connection with the Fidelity Trust Company's draft was in the same form as that sent in the *Eastman Kodak* case quoted above, and the same as the form used by K. N. & K. to advise drafts drawn by "ourselves" (Ex. 6A, p. 164), namely, to "protect" the checks "to the debit" of the customer's account. The argument of the Fidelity Trust Company therefore amounts to this: If A draws his own draft upon his foreign correspondent and instructs that foreign correspondent to "protect" or "honor" the draft to the debit of the customer's account, there is no irrevocable appropriation. But if A

has contracted to "protect" or provide "sufficient funds" for the payment upon presentation of the drafts drawn by B and then advises his—A's—correspondent in precisely the same language as in the case of the drawing of A's own draft to protect or honor B's draft to the debit of A's account, the latter constitutes an equitable assignment or irrevocable appropriation

*There can be no such distinction.* The effect of the advice is just the same. A's obligation is the same in a case where he is the drawer of the draft as it is in the case where by virtue of contract he has agreed to protect the draft drawn by some third person. If the mere instructions to pay and debit are not an appropriation in one case, they are not in the other.

In each case the advice is "a mere letter of instructions to the bankers" (*Hopkinson* vs. *Forster*, *supra*)—in the one case to pay A's draft to the debit of A's account; in the other case to pay B's draft to the debit of A's account.

## No res Ever Existed.

Irrespective of the foregoing, it has not been made clear what "fund" was irrevocably appropriated and held in trust and eventually came into the possession of the Trustee. It is the well settled rule of this Court, as it is in England, that for a reclaimant to succeed, he must identify specifically the property which he claims and trace that specific property or fund into the Receiver's or Trustee's possession.

*Cunningham* vs. *Brown* (1924), 256 U. S., 1, 11;

*Duel* vs. *Hollins* (1916), 241 U. S., 523;

*Schuyler* vs. *Littlefield* (1914), 232 U. S., 707;

*In re Wait* (1927), 1 L. R. Ch. Div., 606.

And further, it is well settled that there can be no trust in or irrevocable appropriation of an aliquot share of a large fund. A reclaimant may only recover by showing the specific property which he claims is his. As Judge Holmes said in *National City Bank* vs. *Hotchkiss* (1913), 231 U. S., 50, at page 57:

> "A trust cannot be established in an aliquot share of a man's whole property, as distinguished from a particular fund, by showing that trust moneys have gone into it."

Because of the impossibility of tracing a *res*, if for no other reason, claims arising from circumstances such as those set forth in the brief of the Fidelity Trust Company cannot be allowed. There can be no trust or appropriation recognized if there is not in existence a fund held in trust or a fund appropriated.

## POINT II.

**The fact that the draft or check drawn by the Fidelity Trust Co. directed the foreign bank "to pay from balance against this check" did not result in an equitable assignment or appropriation of a portion of K. N. & K.'s balance with the foreign bank.**

The lengths to which the Fidelity Trust Company must go in order to sustain its argument and the efforts which are made to avoid the legal effect of the well established banking terms and practices are evidenced by its discussion as to the effect of the words used in the check.

Even the respondent in what must be deemed an exhaustive brief of 121 pages has failed, however, to advance the "argument" here made by the *amicus curiae*. If the argument is understood, it seems to be that the check was not a negotiable instrument because payable out of a particular fund; that, accordingly, it was an equitable assignment; that the Fidelity Trust Company had no balance in the foreign bank either at the time of the drawing of the check or at any other time and that, therefore, the check must constitute an assignment of *K. N. & K.'s* balance in the foreign bank.

The reason for the use of the words "pay from balance against this check" was of course that it was desired that the instruments to be drawn by the inland banks should be considered abroad as "checks" and not "drafts."

In continental Europe, there is a well recognized distinction between "checks" and "drafts." Checks are not subject to the same stamp taxes as are drafts. The identifying feature of a check is that it *purports* to be drawn upon a balance. Accordingly, the forms which K. N. & K. furnished to its innumerable inland customers throughout the country were drawn in the form considered as "checks" in international transactions. The checks were blank checks and the particular country upon which the particular inland bank would draw the check was unknown and therefore a form was provided which would be deemed a "check" in any country.

In *American Trust Company* vs. *Cosmopolitan Trust Company*, 239 Mass., 249, it appears that a check was drawn by the Cosmopolitan Trust Company "against our balance" in an Italian bank. There there was no question of a drawing service and yet this form was used. The check in that case read as follows:

"2514

Boston, Mass. U. S. A.

Lit 2 000 000

August Thirty First 1920

Against our balance

Pay to the Order of American Express Company

Duplicate being unpaid

The sum of Two Million lire

Cosmopolitan Trust Company

(sgd) W. W. Henderson

Assistant Manager.

Foreign Department.

To Credito Italiano

Genoa

Italy

No. 25846

That the distinction between the form of check and draft was evidently the reason for the form of the check here involved appears from the following authorities:

In the *Commercial Laws of the World*, Vol. 25, page 475, for example, there appears a summary of the development of the use of checks in the German Empire,* and it there appears that in order to develop the use of checks as distinguished from bills of exchange, checks at an early date were declared exempt from stamp tax. It also appears that in 1908, there was passed a German check law, which provided that the check must contain a direction addressed by the drawer or the drawee to pay a sum out of his property. But in discussing the effect of the provision the Article referred to states at page 478 that the requirements are merely of a formal nature and that the validity of the check does not depend

*That it was contemplated that checks would be drawn on Germany appears at fols. 425 and 432 and of course from the long list of German correspondents in Exhibit 1.

upon the drawer *actually having* a credit with the bank drawn upon. It is stated that it is the *form* of the check which is important in order to get the benefit of exemption from stamp duty. That all continental Europe recognizes a distinction is pointed out in *Chalmers, Bills of Exchange* (8th Ed., p. 285).

Finally the foregoing is confirmed by the following: In the League of Nations Document containing the Reports on the "Unification of Laws Relating to Bills of Exchange and Promissory Notes" there is included the individual report of Sir MacKenzie D. Chalmers, the British *rapporteur* and the author of "Chalmers on Bills" in which he says, page 99:

> "The Continental view of the function of bills and cheques differs fundamentally from the Anglo-American system. On the Continent a bill of exchange is merely an instrument of settling commercial debts. Finance bills are apparently not recognized. *The cheque is not a bill of exchange, but is an instrument sui generis.*"

This statement is supported by the discussion at page 58 of the same publication.

Even under our system certain courts have said that in order to constitute the draft a check it must purport to be drawn upon a deposit in a banker's hands. On this subject, 2 *Daniel, Negotiable Instruments* (6th Ed. Sec. 1569) says:

> "Sec. 1569. Thirdly. A check purports to be drawn upon a deposit. It is frequently said that a check is drawn upon a deposit in the banker's hands; and the fact that it is so drawn has been held necessary to constitute the draft a check. But this cannot be the true criterion. *It is not the fact that the order is actually drawn on a deposit, but the fact that it purports to be so drawn, which constitutes it a check; and it is more accurate to say that it is upon its face a draft upon a deposit.* To

> hold otherwise would authorize the construction of a written contract by the light of an extraneous fact of which the holder had no notice. If there were no deposit, it would be a fraudulent check—but a check, nevertheless—and we cannot conceive of a wider departure from principle than to hold that the fraud varied the nature of the instrument itself."

In view of the foregoing, it can hardly be seriously argued that because of the form of this check, it constituted an assignment by the inland banks of a portion of K. N. & K.'s balance in the foreign bank. The purpose of the transaction is obvious. The parties desired to use the form which would avoid stamp tax. The inland bank knew that it had contracted with K. N. & K. for the protection of the check. It had sufficient reason to believe that the check, because of this agreement, would be paid upon its presentation. It was justified, therefore, in drawing the check, which purported to be drawn upon a balance despite the fact that it, the inland bank, had no balance with the foreign bank and in fact had no contractual relations with it.

## POINT III.

**The American Dollars were not paid to K. N. & K. by the Fidelity Trust Company to be applied to a particular purpose and to be received and held in a fiduciary capacity.**

The argument in support of this contention has already been set forth at length in the petitioner's principal brief. The recent cases dealing with foreign ex-

change transactions clearly indicate that the courts are unwilling to hamper foreign banking transactions and to impose a trust relationship where in fact none was contemplated and where reliance was placed upon the general credit of the international banker.

The case of *Farley* vs. *Turner*, 26 L. J. Ch., 710, to which reference has been made is not an authority to the contrary, for it is essentially different in its facts from the case at bar. In that case, Goodwin paid to his bankers, Farley, Turner & Jones, £707 with directions that £500 of that money was to be paid to Robarts & Co., another firm of bankers, to meet an acceptance of Goodwin, payable at Robarts & Co. Farley, Turner & Jones then sent certain bills of exchange to third parties and directed that the proceeds thereof be paid to Robarts & Co. for the express purpose of taking up Goodwin's draft. This was done but before it was taken up, one of the partners of Farley, Turner & Jones died and Robarts returned the £500 to the legal representative of the firm. The question was whether this £500 belonged to Goodwin or to the general creditors of Farley, Turner & Jones. The Court held the money had been received by Farley, Turner & Jones to be applied to a particular purpose, and that they in turn had paid the money to Robarts to be applied to a particular purpose, and that, therefore, when the money was not applied to that purpose but was returned, it belonged not to the general creditors but to Goodwin who had paid it for a particular purpose.

It is, of course, to be noted that in that case, Farley, Turner & Jones did not have a general account with Robarts to the debit of which Robarts was directed to pay Goodwin's draft. In that case the Farley firm had not received a consideration from its customer for its service in having the customer's acceptance paid to the debit of the Farley firm's account. It was not held that

the Farley firm had given such directions for the payment of the draft as amounted to an irrevocable appropriation of or an equitable assignment of any of *their general balance*, nor was it held that entries made in Robarts' books constituted an assignment of any of Farley's balance. Nor did that case involve the consideration of the purpose or legal effect of the crediting to a Drafts Payable Account in accordance with international banking practices. It did not involve a foreign exchange transaction or an agreement to provide a credit in foreign currency, which transactions under modern authorities are held to be merely executory contracts for the sale of credit. The case, of course, did not involve the construction of the provisions of a "drawing service" under which innumerable checks are being drawn and advised each day. The case simply held that the Farley firm was merely a conduit for carrying the fund deposited with it by Goodwin to Robarts to meet Goodwin's acceptance. That acceptance was not be paid from any balance belonging to Farley or to the debit of any credit ever owned by Farley. Farley had no absolute obligation toward Goodwin to provide "sufficient funds" to pay the acceptance nor to "protect" it. Farley's sole obligation was to forward the amount deposited by Goodwin. If it were not sufficient to pay the acceptance, there would have been no further obligation on Farley.

Finally, it did not involve the construction of Section 70 of the Bankruptcy Law which vests in the Trustee in Bankruptcy title to all property which the bankrupts could have transferred or over which they had the power of distribution. *Farley* vs. *Turner* involve an isolated transaction where a specific sum was paid for a specific purpose and where the sum thus paid was forwarded with specific instructions to take up a specific draft. The principle underlying it

cannot aid in construing the drawing service, or the purpose or effect of a Drafts Payable Account and the reserved right of cancellation.

## CONCLUSION.

The additional argument made by the Fidelity Trust Company, as *amicus curiae*, simply emphasizes the complications which result from the contention that mere instructions from K. N & K. to their foreign correspondent to protect the draft to the debit of K. N. & K.'s account and the entries in the Drafts Payable Account made anyone other than K. N. & K. a creditor of the foreign bank until the draft was paid. It shows how far-fetched are the arguments advanced in this case to obtain an advantage over the general creditors, all of whom trusted the credit of K. N. & K. By the use of such terms as "balances", "funds" and "transmission," it is sought to obscure what is in its essence a very simple, ordinary banking transaction, namely, the protection by B of the draft of A—the payment of A's draft from B's credit. The conflicting arguments of the respondent and of the *amicus curiae*—the one relying on the "Drafts Payable Account" and the other asserting it to be immaterial—result only in establishing the soundness of the petitioner's interpretation of the fundamental relations of the parties, namely:

That K. N. & K. were acting as *entrepreneurs* who, for a consideration, undertook for American dollars paid in advance that they would have a sufficient credit with the foreign drawee bank upon the presentation of the check drawn by the inland bank, so that the check would be paid to the debit of K. N. & K.'s balance in pursuance of ordi-

nary banking practices and in the same manner as checks drawn by K. N. & K. themselves. For reasons already set forth, until presentation and payment of the checks, the balances in the Drafts Payable Account in law and in equity were subject to the control of K. N. & K. and therefore passed to petitioner as Trustee in Bankruptcy.

Respectfully submitted,

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